

UNDERSTANDING
COSTCO



June 2004

Coriolis Research Ltd. is a strategic market research firm founded in 1997 and based in Auckland, New Zealand. Coriolis primarily works with clients in the food and fast moving consumer goods supply chain, from primary producers to retailers. In addition to working with clients, Coriolis regularly produces reports on current industry topics. Recent reports have included an analysis of Retail Globalization: Who's Winning" and answering the question: "Will selling groceries over the internet ever work?"



The lead researcher on this report was Tim Morris, one of the founding partners of Coriolis Research. Tim graduated from Cornell University in New York with a degree in Agricultural Economics, with a specialisation in Food Industry Management. Tim has worked for a number of international retailers and manufacturers, including Nestlé, Dreyer's Ice Cream, Kraft/General Foods, Safeway and Woolworths New Zealand. Before helping to found Coriolis Research, Tim was a consultant for Swander Pace and Company in San Francisco, where he worked on management consulting and acquisition projects for clients including Danone, Heinz, Bestfoods and ConAgra.



The coriolis force, named for French physicist Gaspard Coriolis (1792-1843), may be seen on a large scale in the movement of winds and ocean currents on the rotating earth. It dominates weather patterns, producing the counterclockwise flow observed around low-pressure zones in the Northern Hemisphere and the clockwise flow around such zones in the Southern Hemisphere. It is the result of a centripetal force on a mass moving with a velocity radially outward in a rotating plane. *In market research it means understanding the big picture before you get into the details.*



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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, founder, Price Club, March 1985


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COSTCO PROFILE

Costco is a \$42.5 billion company that operates wholesale club stores in seven countries

Costco profile (as of FY 2003)

	Name: Costco Wholesale Corporation CEO/President: James D. Sinegal Ownership: Public (Nasdaq: COST)	Address: 999 Lake Dr. Issaquah, WA 98027 United States Telephone: +1 (425) 313 8100	
	Total sales: \$42,546m ¹ Sales CAGR (98-03): 9.8% Operating Income: \$1,157m Operating Income CAGR (98-03): 5.1% Operating Income margin: 2.8% Total assets: \$13,192m ROA (OI/TA): 8.8%	# of employees: 103,000 Sales/employee: \$404,786 # of stores: 407 / 430 incl Mexico Sales/store/week: \$2,010,300 Operating Income/store/week: \$56,045 Supermarket market share in home country: 8% Percent of sales outside home country (ex Mexico) 23%	
Countries (7)		Store Formats	Store Fascias
United States (318) ¹ Canada (62) Mexico (23) ² United Kingdom (15)	South Korea (5) Japan (4) Taiwan (3)	Wholesale Clubs (396) Home Furnishings (1)	Costco

COSTCO CORPORATE STRUCTURE

While Costco operates 430 units in seven countries, North America accounts for the bulk of turnover

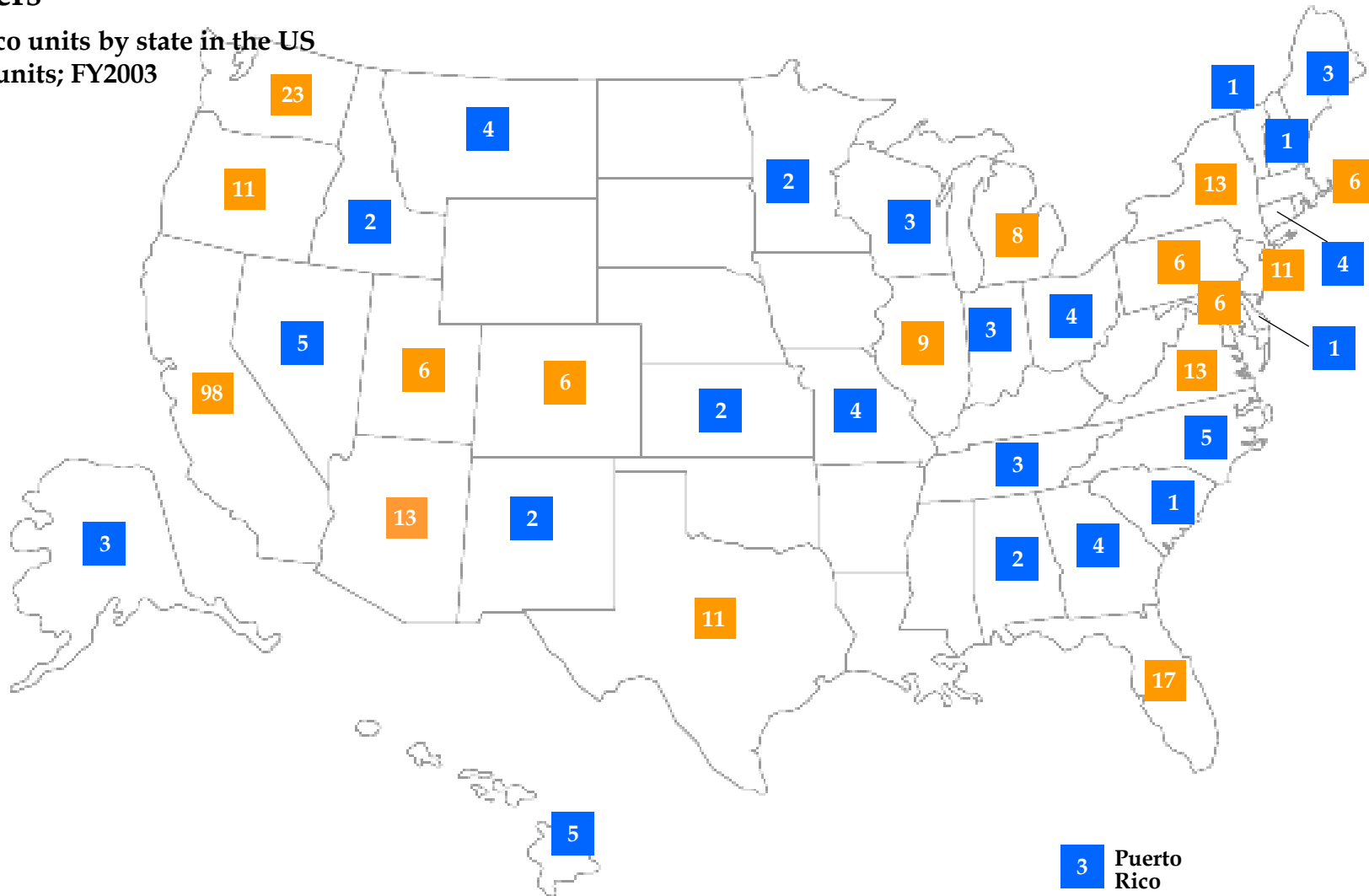
Costco international sales and structure
US\$, millions, FY2003



COSTCO UNITED STATES UNITS BY STATE

In 2003 Costco operated 318 units in the United States, concentrated in the coastal population centers

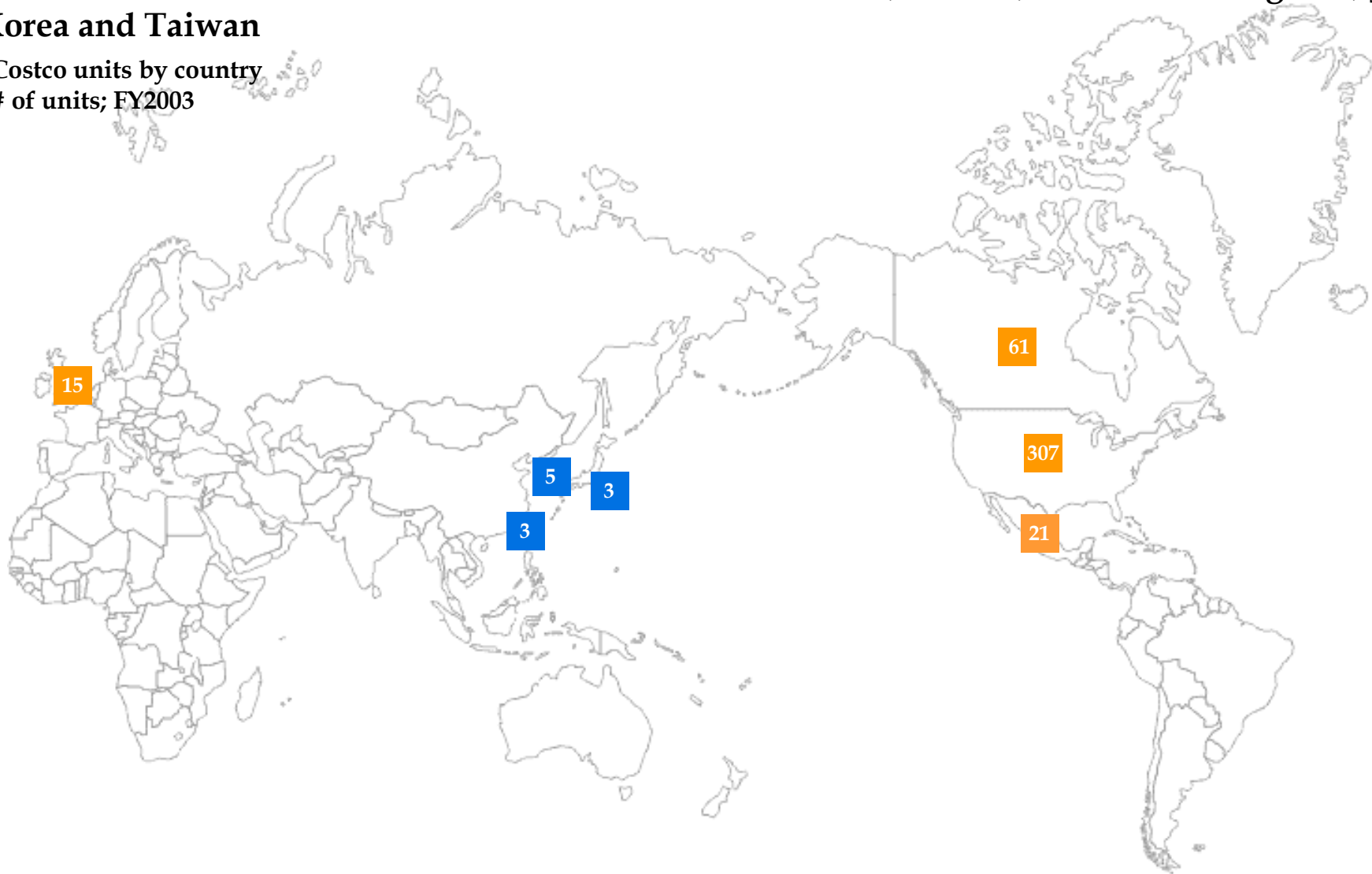
Costco units by state in the US
of units; FY2003



COSTCO GLOBAL UNITS BY COUNTRY

To date Costco has entered six additional countries: Canada, Mexico, the United Kingdom, Japan, Korea and Taiwan

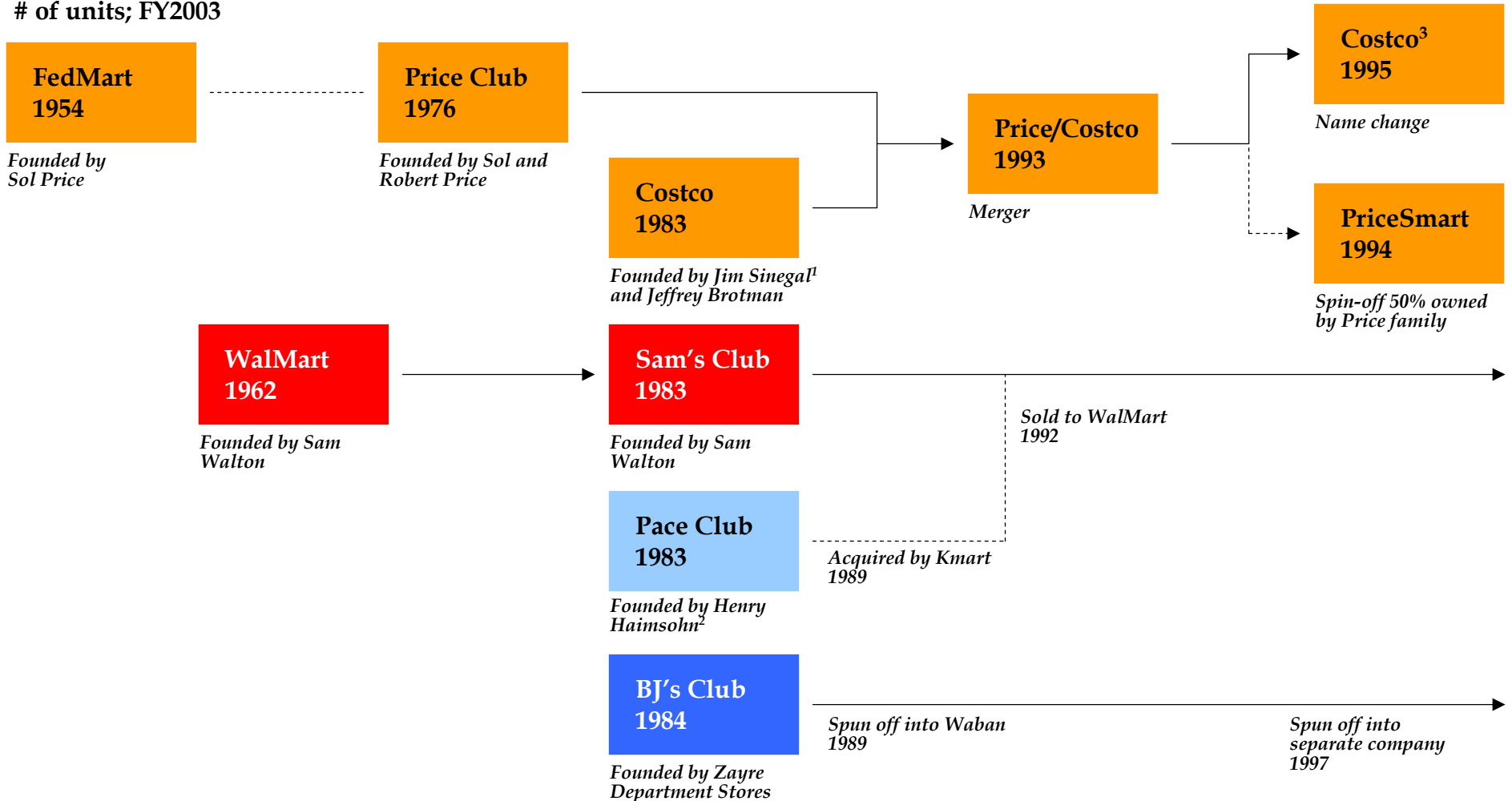
Costco units by country
of units; FY2003



COMPANY ORIGIN

Costco is the product of a merger between Price Club, the originator of the wholesale club, and Costco, the greatest imitator

Development of key players in the wholesale club industry
of units; FY2003



DEFINITIONS

Costco is a wholesale (or membership) club store, a high-volume, limited range store format

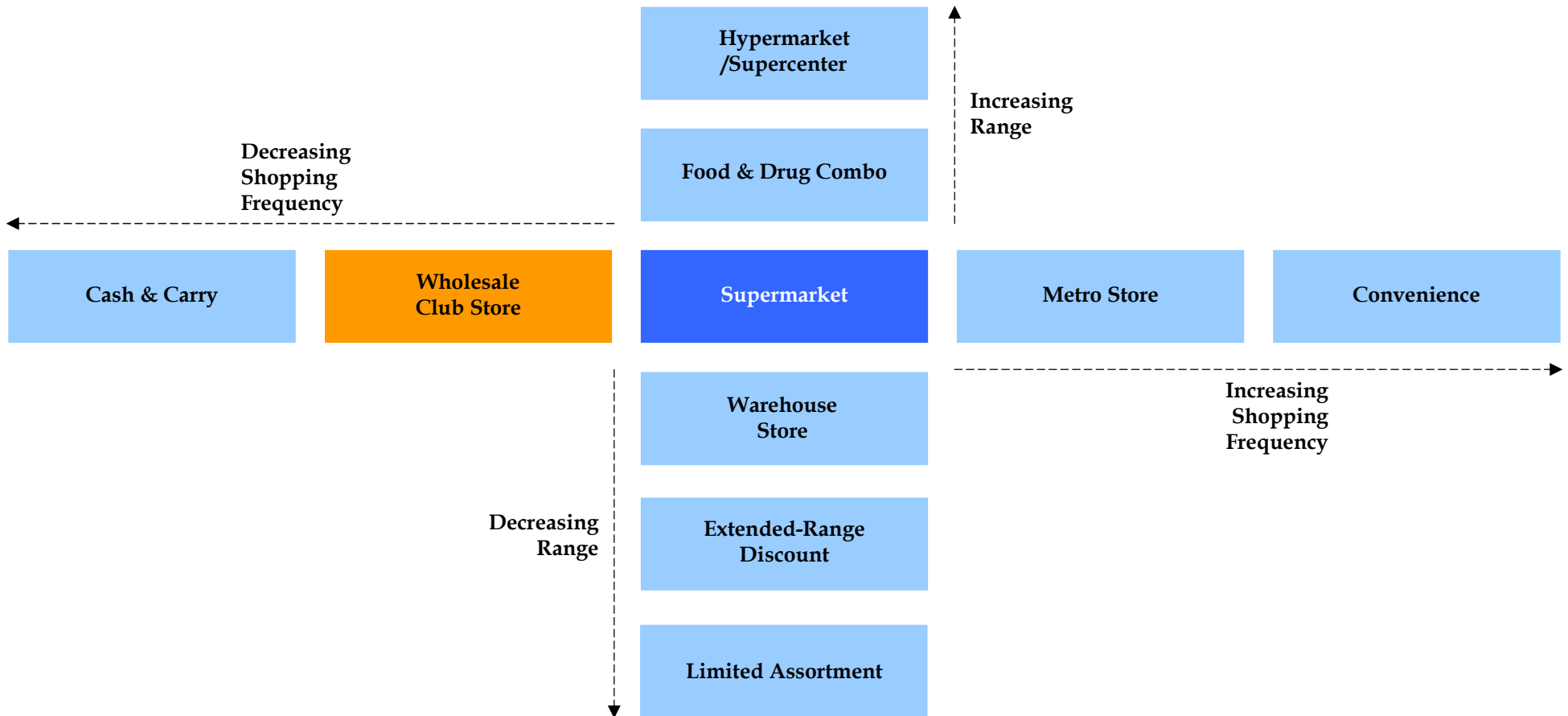
Definitions of major supermarket-type retail store formats
select variables

	Average Size	Average Weekly Sales (\$A)	Average Number of SKU	Average Weekly Sales/m2	Global Segment Leader	Australasian Example
Convenience Store	200-300m2	\$40,000	3,000	\$133	7-Eleven	7-Eleven
Metro Store	800-1,200m2	\$200,000	13,000	\$200	Tesco Metro	Woolworths Metro
Supermarket	2,000-4,000m2	\$350,000	20,000	\$115	Kroger	Coles
Warehouse Store	4,000-7,000m2	\$900,000	10,000	\$150	Cub or Winco	Pak’N Save
Extended-Range Discount	1,000-2,000m2	\$200,000	3,000+	\$135	Colruyt	Franklins
Limited Assortment Discount	600-1,200m2	\$150,000	800-1000	\$190	Aldi	Aldi
Food & Drug Combo	5,000-6,000m2	\$600,000	40,000	\$110	Albertsons	[Illegal] ¹
Hypermarket/Supercenter	10,000-19,000m2	\$1,500,000+	80,000	\$110	Wal-Mart or Carrefour	[Super Kmart]
Wholesale Club Store	10,000m2	\$3,000,000+	4,000	\$300	Costco	[Cost-U-Less]
Cash & Carry	7,000-8,000m2+	\$1,000,000+	12,000-25,000	\$125	Metro/Makro	Campbell’s

POSITIONING

The wholesale club store format is positioned as having a lower shopping frequency and less range than a conventional supermarket

Major supermarket-type retail store formats by positioning model



A DIFFERENT SHOPPING EXPERIENCE

Shopping at Costco is a different experience from shopping at other stores

- "I had begun to have a disturbing feeling that everybody in the Bay Area belonged to the Club but me. While I am out at the No-Price-2-Hi store, paying full retail, they're out there in their minivans, loading up on cassette tapes and frozen asparagus...

When we arrived at the huge windowless warehouse, I looked around, riveted, at the stereos, cookware, film, watches, jewelry, liquor gift sets, razor blades, tires, socks, sheets, stationery... I grabbed an oversized orange cart and headed into the crowd. Some people were pushing industrial pallets, piling toilet paper and pancake mix and cases of Kahlua on them as if it had been announced that all buying everywhere in the world would cease in 15 minutes. I began to throw things into my cart, at first slowly, then faster and faster. My list forgotten, I lobbed in everything I saw that I have ever used: a 24-pack of film, a lifetime supply of tampons, 100 plastic tumblers, champagne, couch throws, Christmas wrap, Reeboks I didn't even try on...

Everybody I saw was doing the same thing. It was as if we were all Scarlett O'Hara in *Gone With the Wind*, whispering, "As God is my witness, I'll never pay retail for toilet paper again." Veterans say it's dangerous to let people go to the Price Club alone the first time out. "A gallon jug of maple syrup," the novices think. "What a good idea. A case of gallon jugs of maple syrup - what an even better idea." *Lara Adair, Reporter, San Francisco Chronicle, December 1989*

- "The oversized carts match the oversized purchases, but sometimes even they are not big enough... Unless it's institutional-sized ketchup or jumbo cereal, there's never just one can, box, bottle or carton; two or three or four are packed together. There's never just one kilogram of meat in a tray... Baby carrots are purchased in five-pound bags... A 500-millilitre tub of those hot little feta-stuffed red jalapeños is \$6.95... 15-year-old balsamic vinegar, one litre for \$14.59... At this point, I am becoming embarrassed to admit this sort of wretched excess and feel compelled to say it doesn't happen often. The warehouse club is, after all, an American concept. It was nurtured and flourished in that ultimate land of plenty, where conspicuous consumption is more apt to be a lifestyle... Warehouse club prices *are* hard to beat. But you can't get everything on your shopping list. You end up buying stuff you don't need — lots of it. You walk out spending more than you expected to." *Susan Sampson, Food Writer, Toronto Star, November 2003*

DOCUMENT OVERVIEW

This report is structured into the following five sections:



SECTION 1: TARGET MARKET

The first section of this report looks at Costco's target customer which, different from most discounters, is small businesses and high income households







"The richer people are, the more they like to save."

Sol Price, Founder, Price Club, December 1988

MEMBERSHIP OPTIONS

Customers have to pay an annual membership fee of at least US\$45 to shop at Costco

Costco Membership structure and fees
\$, actual, 2004

	Type of Membership	# of Members	Annual Cost	Key details
	Gold Star (Consumer) Membership	15.0m	\$45	Individuals who do not qualify for business membership Includes spouse card
	Executive Gold Star Membership		\$100	As individual plus: Executive members receive an annual 2% reward on most Costco purchases Qualify for additional benefits from service providers
	Business Membership	4.6m	\$45	Business identification required when applying Licensed businesses, nonprofit organizations, government agencies, farmers & ranchers Can start shopping at 10am rather than 11am (Monday to Friday) Includes a spouse card; additional business membership cards cost \$35 each
	Executive Business Membership		\$100	As business plus: Executive members receive an annual 2% reward on most Costco purchases Qualify for additional benefits from service providers

*There are 2 million total executive members who account for 25% of sales
No breakout by type (consumer vs. business) is available*

MEMBERSHIP CREATES EXCLUSIVITY

Costco uses membership to create exclusivity and a bond with its customers

- Membership was originally limited to businesses and members of select groups (e.g. government employees) – criteria have since been widened to allow anyone willing to pay to join.
- **“It was unimaginable, this idea, that you could charge people to shop.”** *Michael Exstein, analyst, Shearson, December 1988*
- **“We thought of it as a speak-easy. We tried to create a mystique.”** *Robert Price, President, Price Club, December 1988*
- **“The membership concept is very important to us. First, membership provides a way for us to pre-select the demographics of our customer base without having to do all the extensive research that would otherwise be requires. Business owners and managers, licensed professionals, and people who work for governments, utilities, hospitals or banks tend to be more stable than many other. We take less risk in accepting their checks. Second, dealing exclusively with selected groups makes it possible to communicate with your customers effectively. Instead of communicating with the whole world, you communicate one-on-one with the people you want to reach. Finally, someone who pays for a membership in an organization makes a form of commitment. They have a built-in reason to come back.”** *Sol Price, founder, Price Club, November 1990*
- **“The Costco trick is to lure people in with the promise of bargains and, when they see what's on offer, persuade them to spend more than they intended. Its membership criteria concentrates on those with a pocket deep enough for impulse buying. The poor and unemployed are not invited to this party.”** *Super Marketing, November 1993*
- **“The ‘wholesale’ concept is crucial to the company's image. Wholesale customers account for 60% of total sales.”** *Chain Store Age, May 1983*
- **“Sol Price was the first to realize that by getting certain groups to shop in his store, he could get a high-quality client at a reasonable cost. It pays for whatever marketing budget you need.”** *Walter Teninga, Chairman, Warehouse Club, Nov 1989*

MEMBERSHIP CONTROLS THEFT

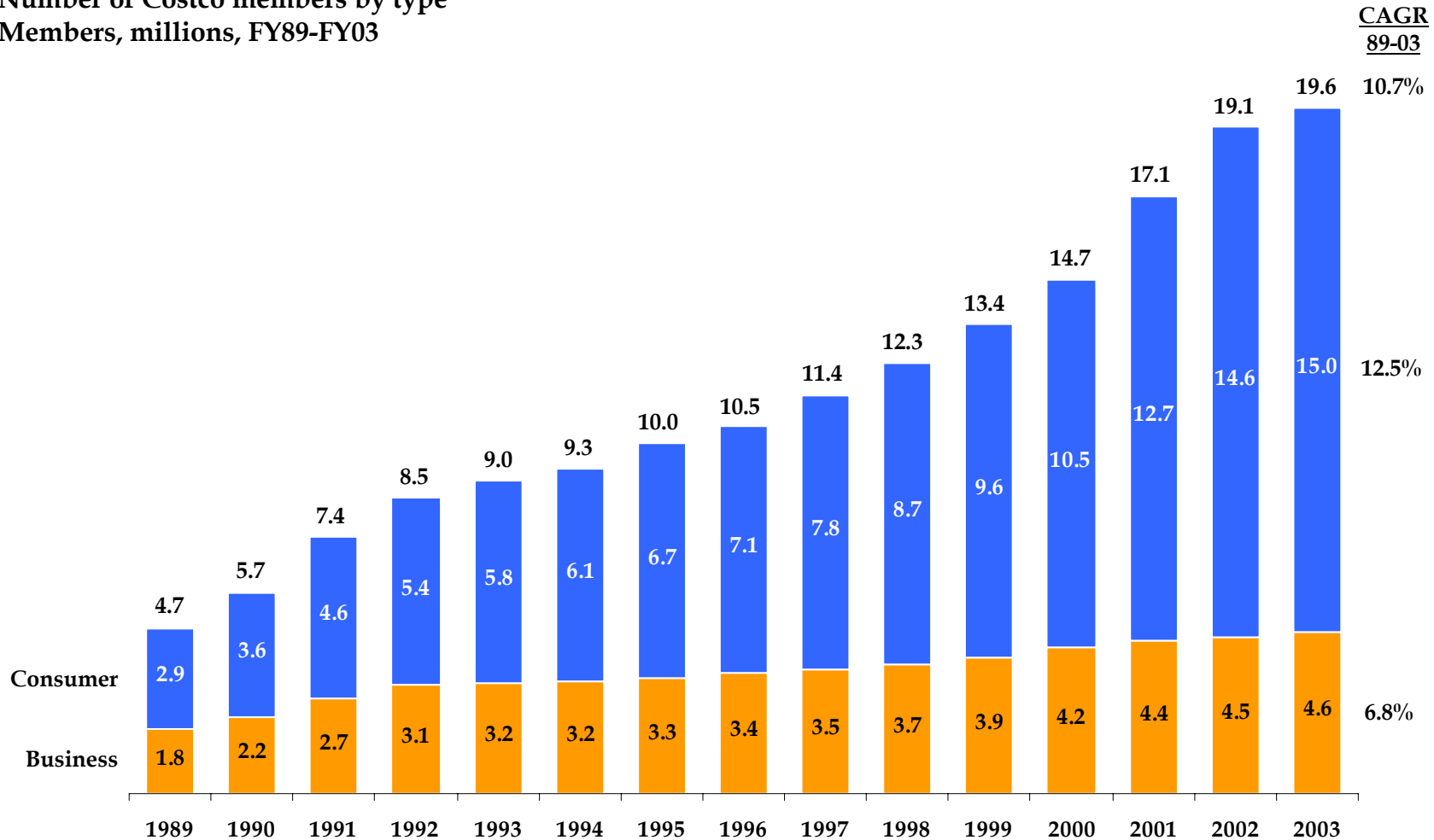
Membership also significantly reduces customer theft

- **“Our members have a sense of ownership in our store. They identify it as their place, their club, and that certainly help us keep shrink down. It's another reason the membership concept is so important. Also, one of our routine procedures is to have a security person at the door to verify each order as the customer leaves. Sometimes we catch a checker error, and we create an atmosphere that discourages the shoplifter.”** *Sol Price, founder, Price Club, November 1990*
- **“A customer who has to fill out a membership form listing name, address, affiliation, phone number and Social Security number is less likely to write a bad check - and will be easy to find if he does.”** *Money, October 1985*
- **“Screening the members allows Costco to control who gets in the stores. This cuts down on bad checks and pilferage; shrinkage is only 0.2% of sales, one-tenth the level of many supermarkets.”** *Forbes, August 1997*

MEMBERSHIP NUMBERS

Consumer (or Gold Star) members are growing faster than business members

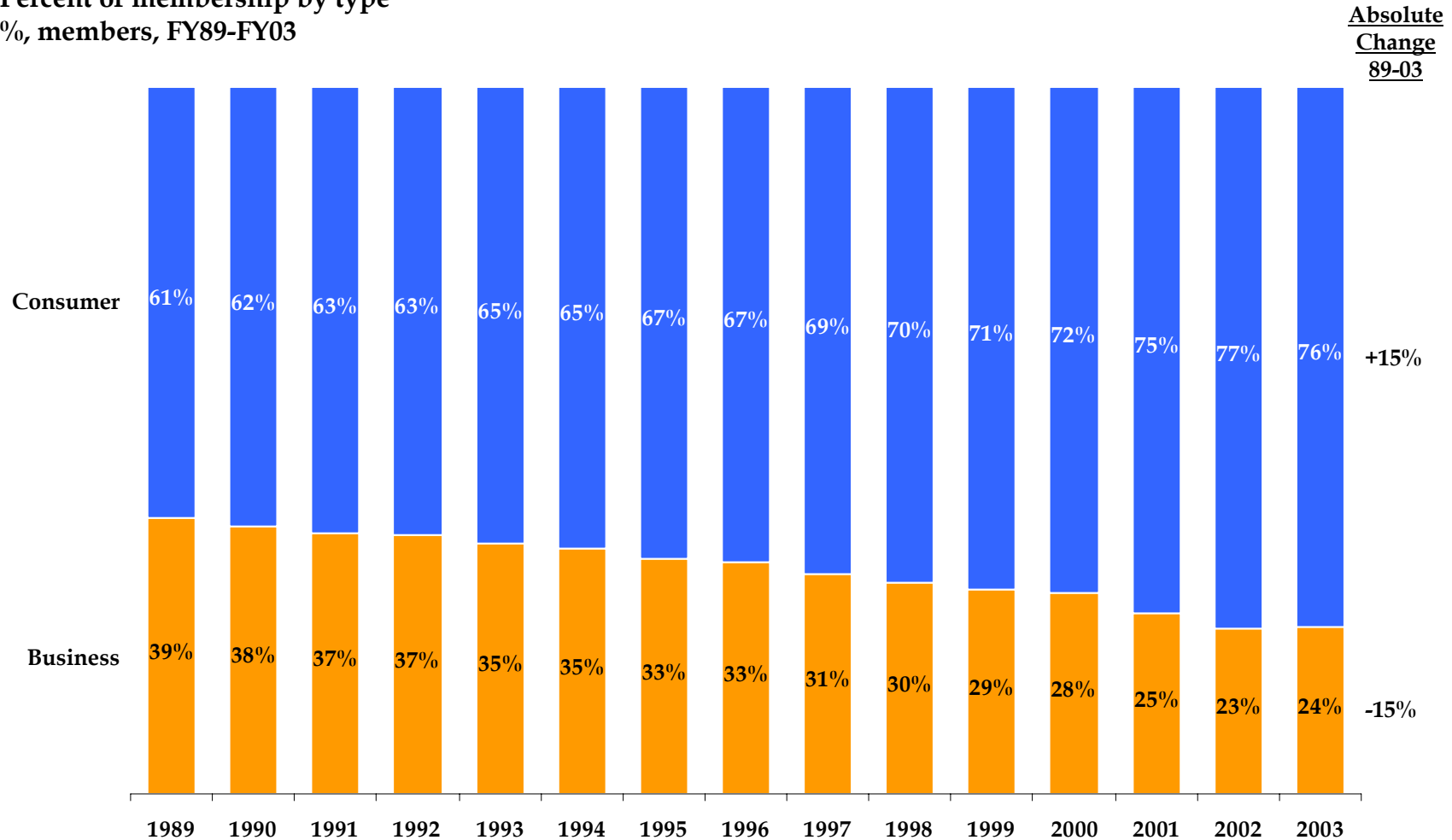
Number of Costco members by type
Members, millions, FY89-FY03



MEMBERSHIP BY TYPE

Consumer membership continues to grow in importance relative to business membership

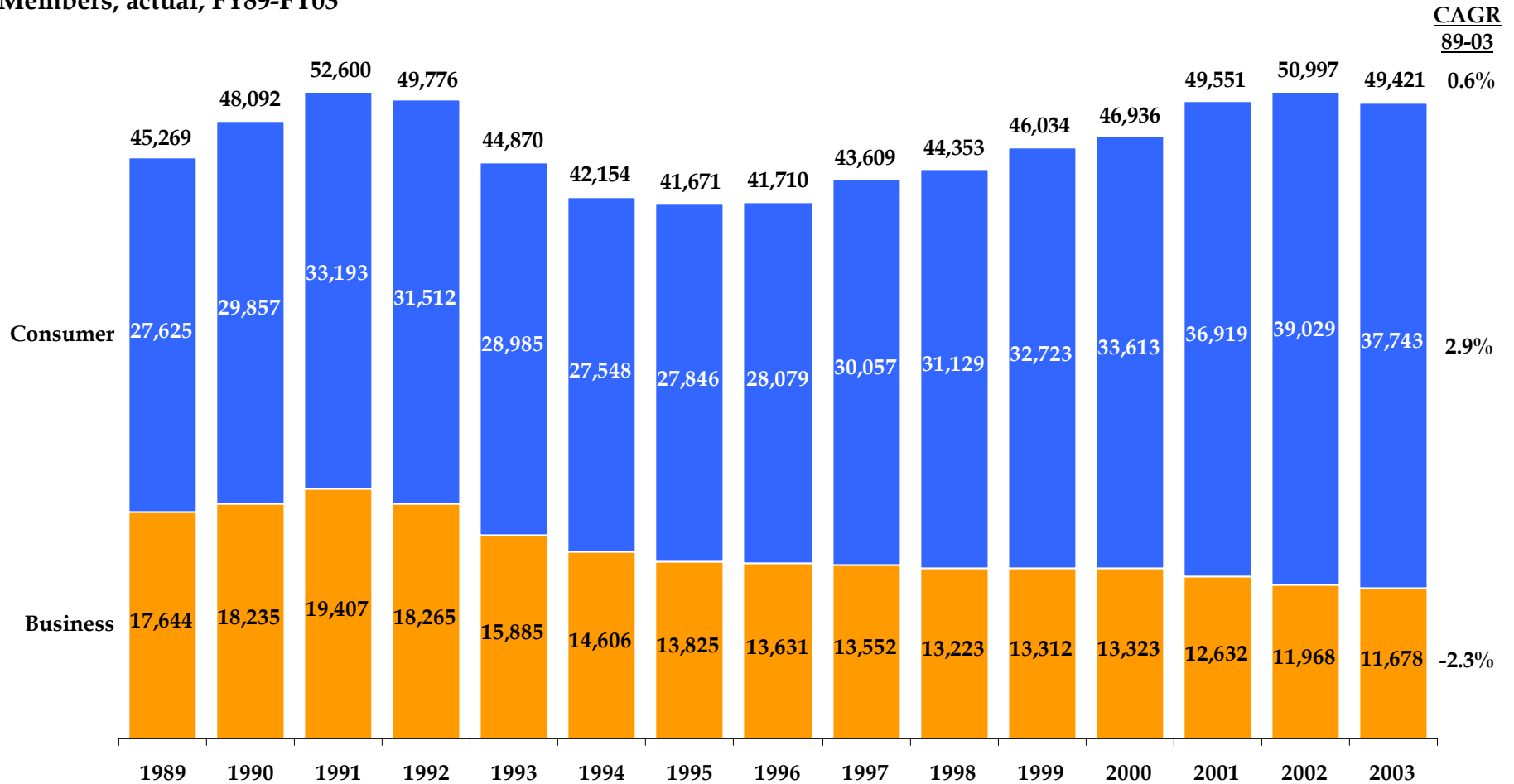
Percent of membership by type
%, members, FY89-FY03



MEMBERSHIP PER CLUB

Membership per club has recovered from its slump in the early 1990's, although the number of business members per club continues to decline

Members per Costco club by year
Members, actual, FY89-FY03



LOYALTY

Costco has a strong base of loyal customers

- **“Costco's membership renewal rate is nearly 97% among active businesses. In 18 years of this work, I've not seen anything like that in retail. That's more than patients' loyalty to physicians.”** *Jim Hebert, Hebert Research, August 1997*
- **“Membership renewal rates remain high as a result of constant product innovation and value perception. We think the membership model works and, by rewarding loyalty, Costco has generated industry-leading comparable-store sales. In a low-margin business, success is achieved by increasing the frequency and average purchase of each club member.”** *Janice Hofferber, analyst, Fulcrum, October 2002*

MEMBERSHIP FEES DRIVE PROFIT

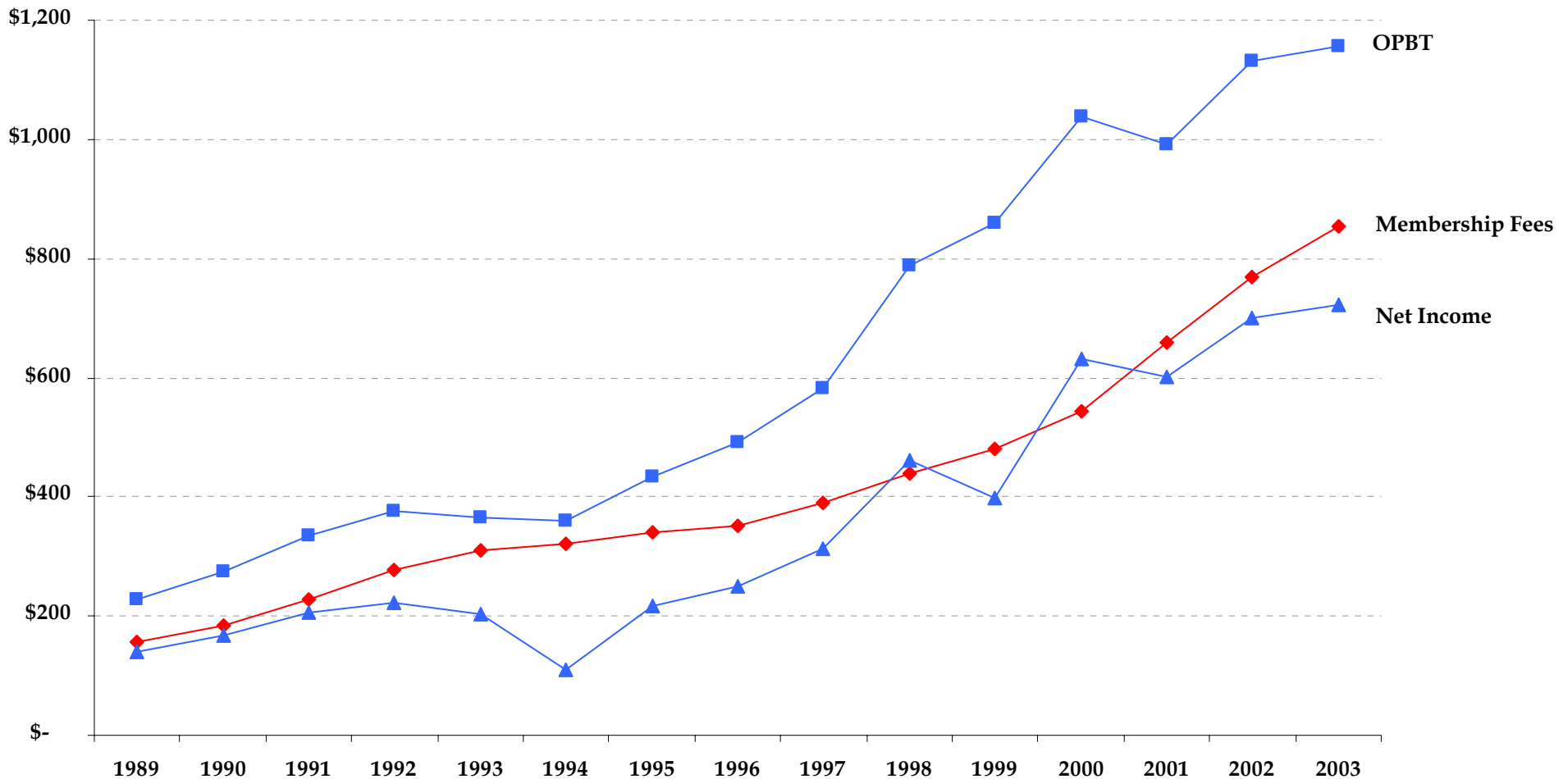
Membership fees are widely recognised as a key driver of sales and profitability

- **“The warehouse clubs also charge a membership fee, ranging from \$45-100. This is almost 100% profit and helps to provide a strong incentive to customers to save enough through their purchases to offset the cost of membership. Given that this is a low-margin business, membership fees can account for about 50-55% of operating profits, adding some predictability to at least half of the earnings stream, provided there are no major deviations in membership growth and retention rates. Membership at Costco consists of either gold star or business classes.”** *Daniel Binder, analyst, BBH, August 1999*
- **“Our membership fees range from \$25 to \$35 [in 1990]. If you take that money and put it back into lower prices, it begins to feed on itself. The more the member buys, the greater the return on that \$25 investment. If someone buys \$2,500 worth of merchandise, the membership fee is only 1 percent. If they buy only \$500, they have paid 5 percent for the privilege of buying at wholesale prices. If you're honest about it, you take that membership money and put it back into lower prices. That way you have, in effect, increased your leverage to keep the customer and have the customer buy more and more from you.”** *Sol Price, founder, Price Club, November 1990*

MEMBERSHIP FEES DRIVE PROFIT

The data seems to support the commonly heard argument that membership fees are Costco's profit and the rest of the business is run "at cost"

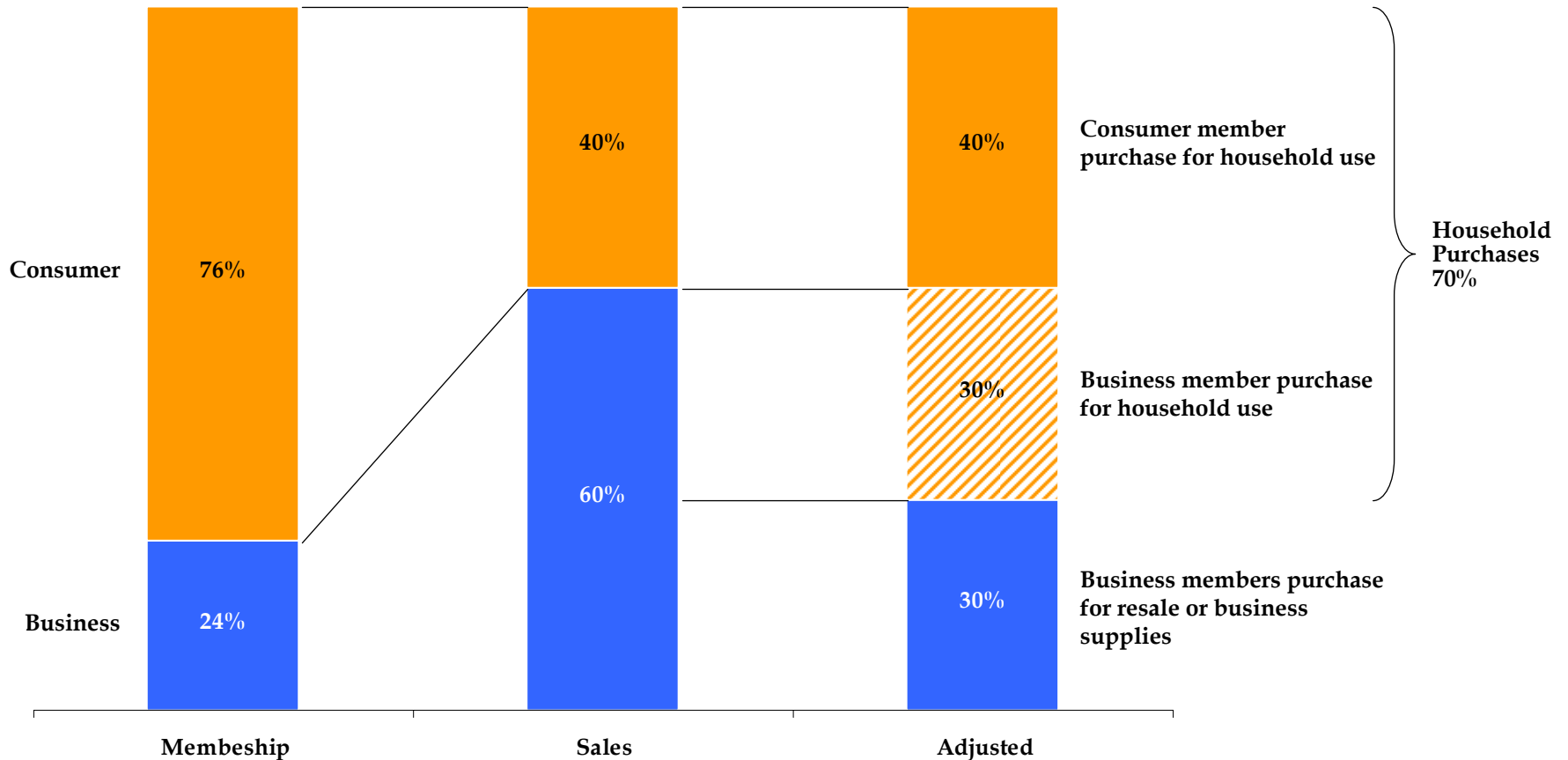
Costco OPBT, net income and membership fees by year
 \$, millions, FY1989-FY2003



RELATIVE IMPORTANCE

Consumers account for 76% of memberships, but only 40% of sales; businesses account for 24% of membership and 60% of sales, but it is estimated 50% of business sales are for household use

Breakdown of membership by number and share of sales
%, 2003



UNIT SALES COMPOSITION BY TYPE OF MEMBER

Business customers spend more per visit and visit more frequently, thus increasing their relative importance

Composition of sales by membership category
2003

ESTIMATE

Type of Member	Average Transaction		Shopping trips Per year	=	Annual spend per customer	X	Average members per unit	=	Annual aggregate sales
Consumer (Gold Star)	\$94	X	11.4	=	\$1,072	X	37,743	=	\$40.4m
	↓ 2.4X		↓ 2X		↓ 4.8X		↑ 3.2X		↓ 1.6X
Business	\$230	X	24	=	\$5,530	X	11,678	=	\$64.6m
			<i>Business customers shopping more frequently</i>						
									<u>\$105.0m</u>

SMALL BUSINESSES FORM THE CORE

Small business customers form the original loyal core of the Costco customer base

- **“Price was 59 when he was ousted from Fedmart. He took to strolling through San Diego, chatting with grocery store owners, restaurateurs, the people who ran the newspaper and candy stands. He discovered a gap in the retail marketing network, just waiting to be filled. At the time, owners of small businesses could either deal with four or five wholesalers or they could go to cash-and-carry operations with limited stock and pay higher prices. Price was convinced that if he could keep prices down and yet put everything a small business customer needed under one roof, he’d have a winning formula.”** *New York Times, December 1988*
- **“We are operating businesses that are both retail and wholesale. From the beginning, our concept was to provide a cash and carry warehouse where business people who need something less than a truckload of merchandise can buy what they need conveniently and economically. At the same time, it seemed logical to offer the same convenience and value to qualified retail customers, who are willing to shop like wholesale customers without the service, breadth of product selection, and credit terms offered by most retail stores. Why should there be a difference between retail and wholesale? The powers that be have fixed in our minds that retail and wholesale should be different. In some cases, it's just one more step in increasing the cost. If a wholesaler is performing a real function, fine. But in many instances he's not, so why should there be an additional charge in there?”** *Sol Price, founder, Price Club, November 1990*
- **“Wholesaling is the reason for being of this concept. Retail is just the icing of the cake.”** *Mervyn Weich, President, BJ's Wholesale Club, February 1985*
- **“Price Club stays ahead the competition by paying particular attention to serving our members. We also focus very heavily on our business members and satisfying their needs.”** *Brent Knudson, VP Marketing, Price Club, November 1988*
- **“The business customers are very important for us. That's why we're as restrictive as we are. We don't want to drive those customers away.”** *Jim Sinegal, CEO, Costco, Dec 1990*

TEN MOST COMMON BUSINESS MEMBERS

Foodservice, traditional cash & carry customers and small businesses make up a large part of Costco's business membership

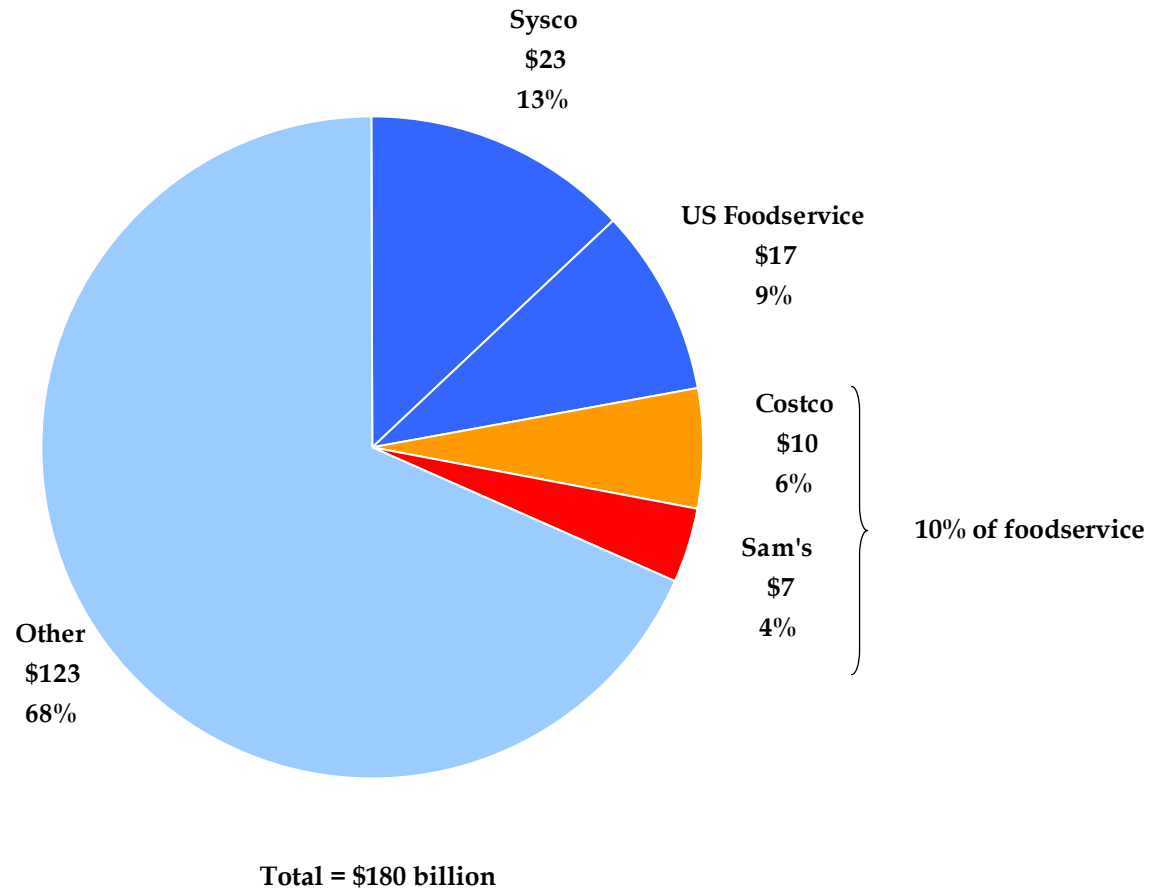
Ten most common business members by type
Ranking, 2003

1. Restaurants
2. Vending
3. Gas Stations
4. Day Care Centers
5. Convenience Stores or Small Grocers
6. Professionals (Doctors, Lawyers)
7. Hotels & Motels
8. Hair Salons
9. Caterers
10. Construction

MARKET SHARE IN FOODSERVICE

Costco and Sam's Club now account for ten percent of foodservice sales in the United States

Foodservice distributor market share by company
\$, billions, percent of sales, 2003



TARGETS A HIGH INCOME CUSTOMER

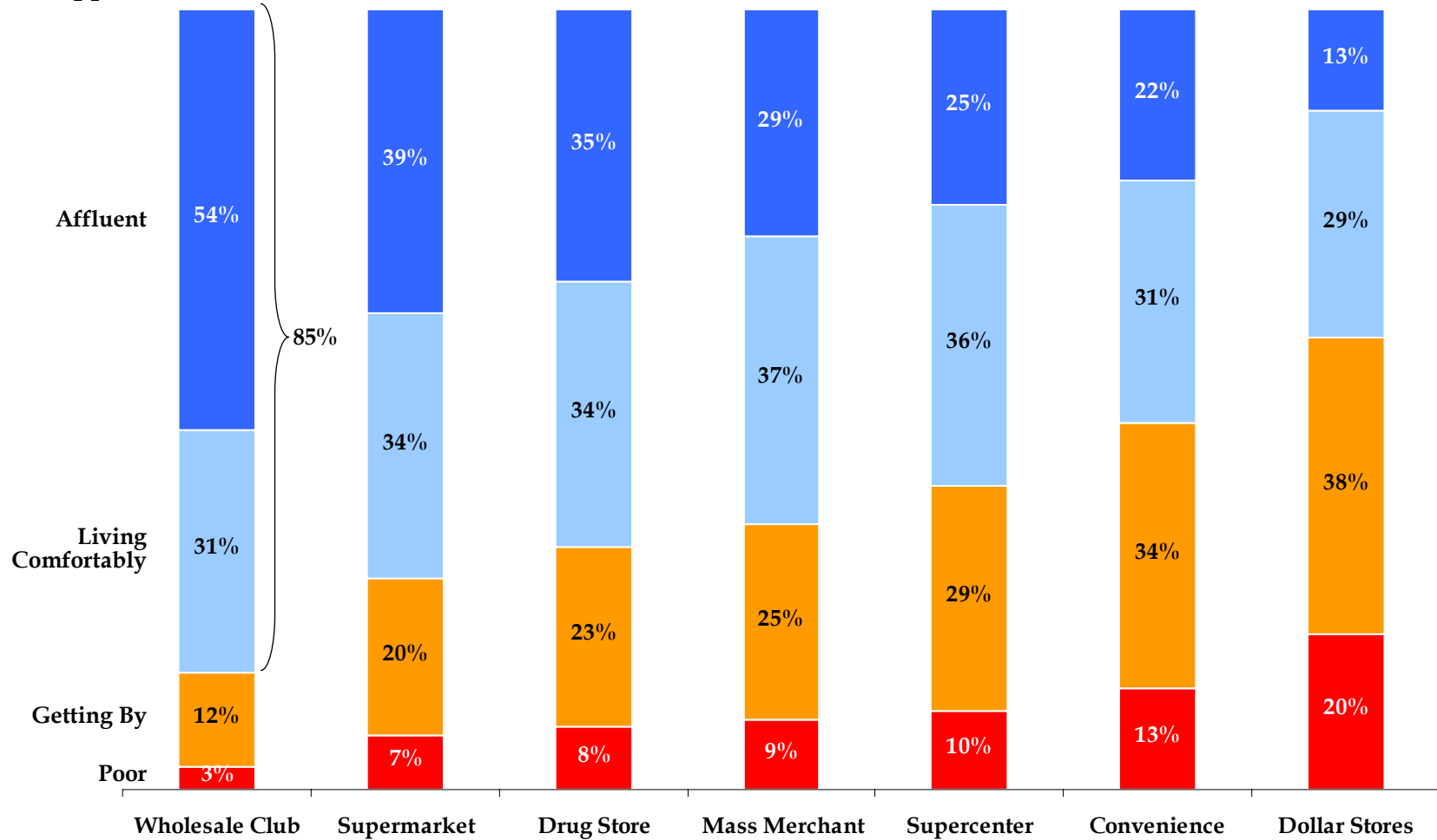
Unlike other discount formats, the Costco offer strongly attracts a high income customer

- **“The Costco concept is aimed at college educated households, with \$70,000 to \$80,000 per year household income, and with two cars. It's a completely different business model than Wal-Mart.”** *Mark Husson, analyst, Merrill Lynch, April 2002*
- **“Unfortunately, people with low income cannot afford to shop at Costco.”** *Neil Currie, analyst, UBS Warburg, April 2002*
- **“We understood that small-business owners, as a rule, are the wealthiest people in a community. So they would not only spend significant money on their businesses, they'd spend a lot on themselves if you gave them quality and value. Jim [Sinegal] saw that you had to be just as much a merchant as Saks Fifth Avenue. You couldn't entice a wholesale customer with 20-pound tins of mayonnaise; you had to romance him with consumer goods.”** *Jeffrey Brotman, Chairman, Costco, November 2003*
- **“We continue to believe that Costco plays on a positive environment for higher-income consumers--our most recent positive, anecdotal feedback regarding the clubs' merchandise mix has come unsolicited from numerous East and West Coast investment bankers!”** *Barbara Miller, analyst, Alex Brown, March 1997*
- **“There's an old story they tell at Costco Wholesale Corp.: A Costco customer goes into one of the Issaquah based chain's warehouses and sees Polo Ralph Lauren shirts that go for \$60 retail selling for \$37. The customer says, "I'll take four in white and one in blue.” A customer of rival Sam's Club sees the same display and says, "I don't care how good a shirt it is, I'm not spending that much.”** *Puget Sound Business Journal, July 2003*
- **“I think it's the merchandising effort, as well as who we go after in terms of our member. Our member tends to be a higher-end member, both small business owners and managers, as well as higher-end consumers, and our merchandising efforts reflect who our members are.”** *Richard Galanti, CFO, Costco, September 2001*

DEMOGRAPHICS - INCOME

Eighty-five percent of heavy wholesale club shoppers are from the upper income groups

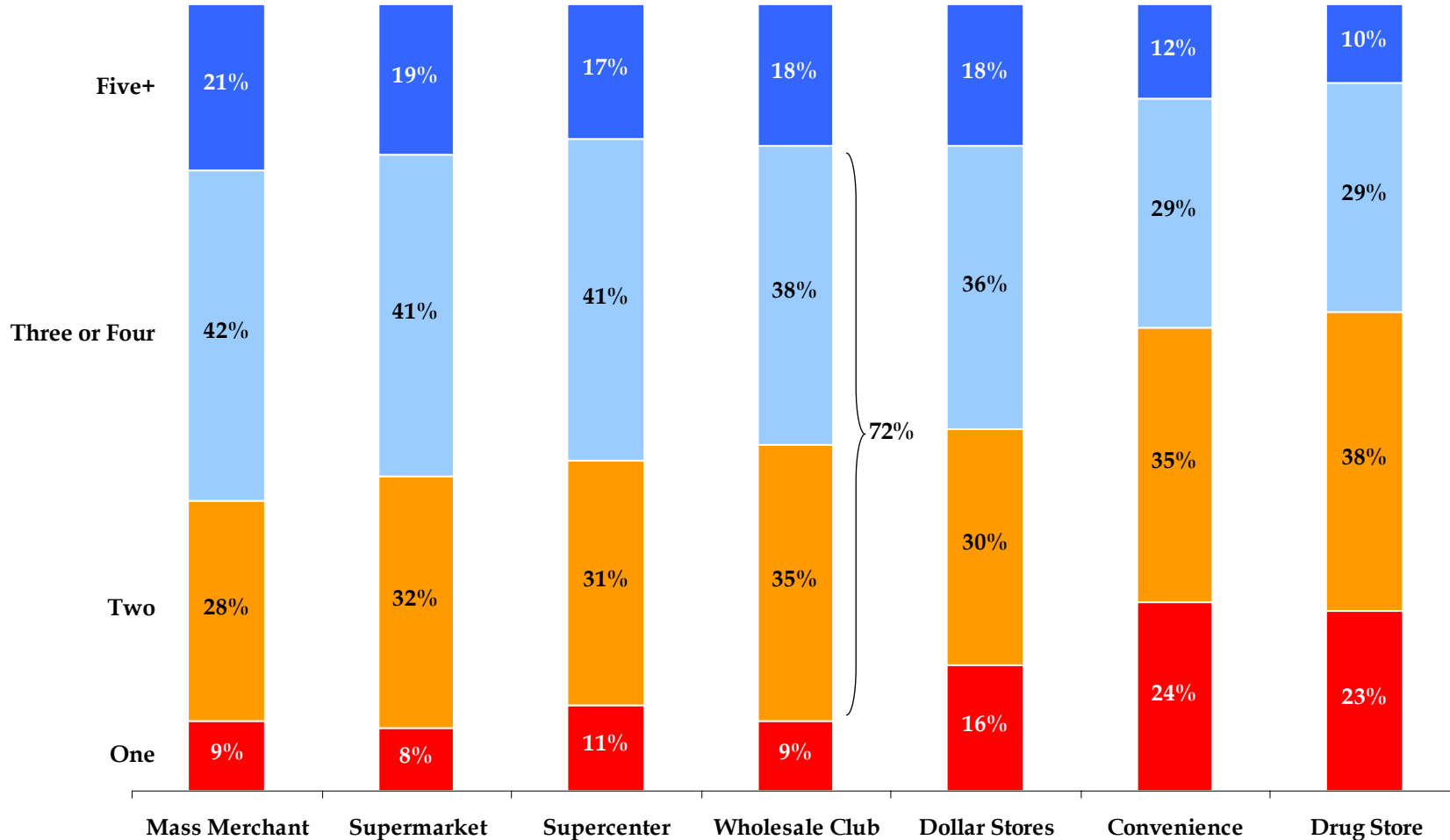
Comparative demographics of heavy shoppers by income by store format in the US market
% of shoppers, 52we 2002.12.28



DEMOGRAPHICS - HOUSEHOLD SIZE

Seventy-two percent of heavy wholesale club shoppers are from two to four person households

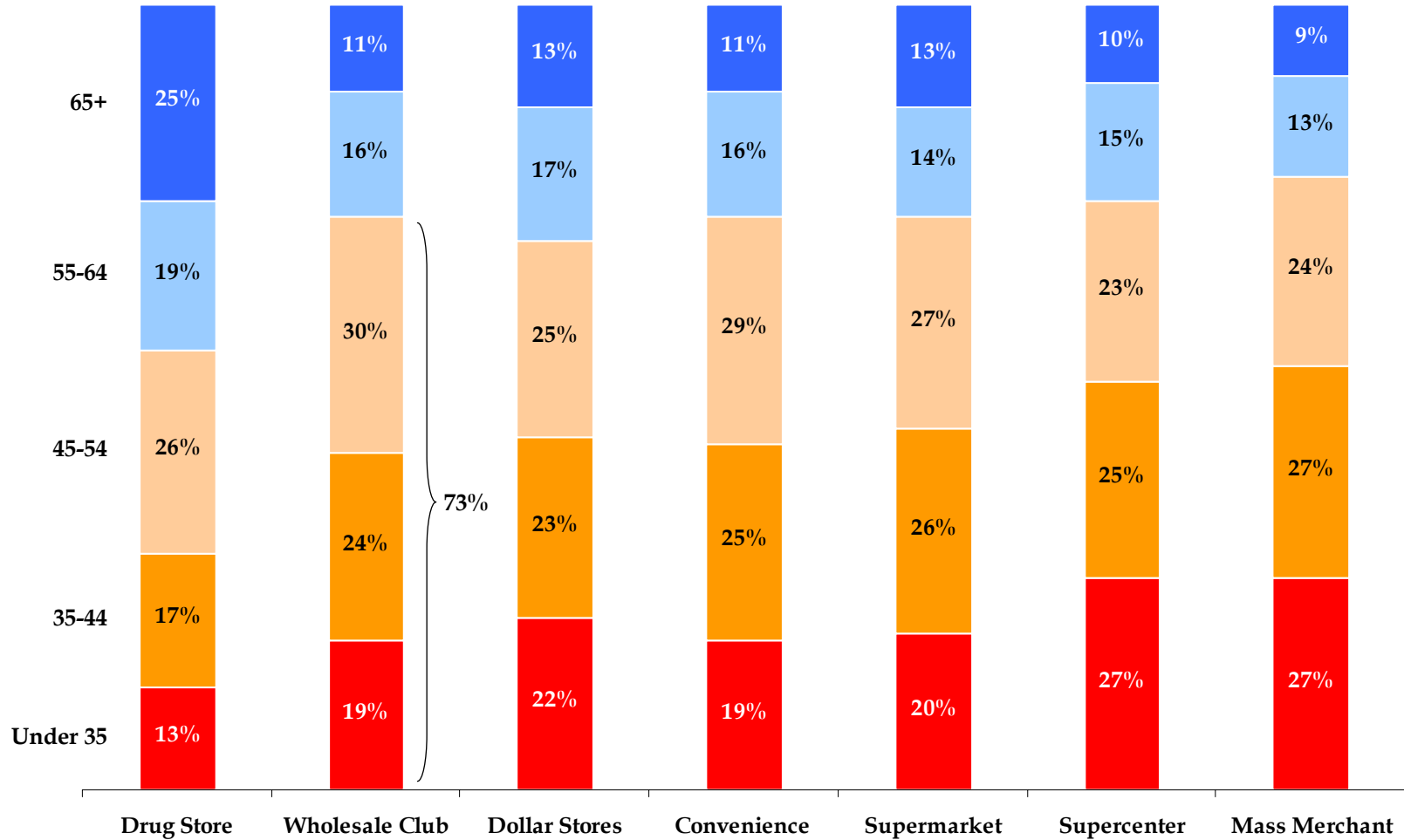
Comparative demographics of heavy shoppers by household size by store format in the US market
% of shoppers, 52we 2002.12.28



DEMOGRAPHICS - AGE

Seventy-three percent of female heavy wholesale club shoppers are under 55

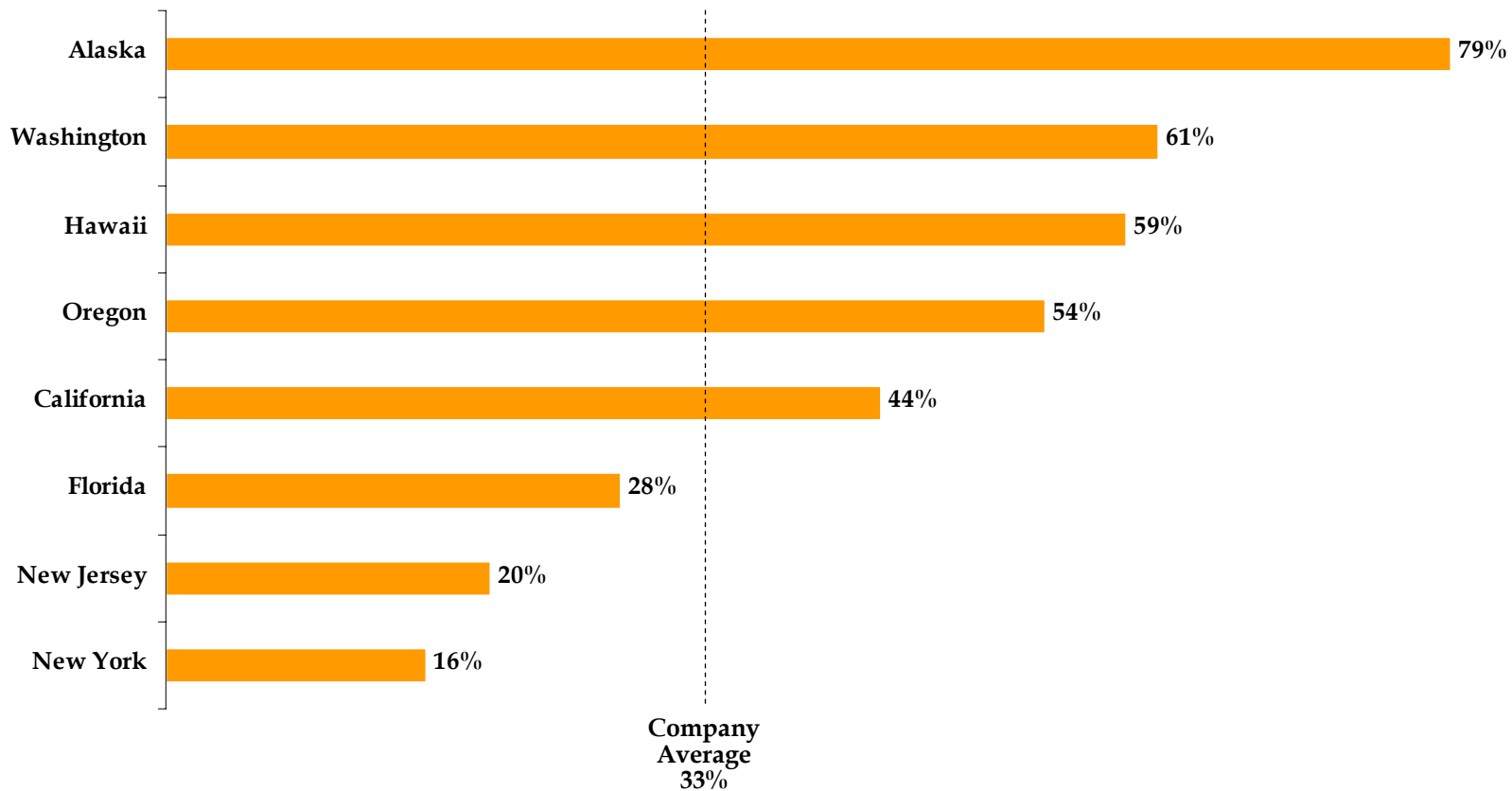
Comparative demographics of female heavy shoppers by age by store format in the US market
% of shoppers, 52we 2002.12.28



HOUSEHOLD PENETRATION BY STATE

While household penetration averages 33% across states where Costco operates, some states have much higher penetration

Percent of households with Costco membership in select states
% of households, 1999



SALES BUILD OVER TIME

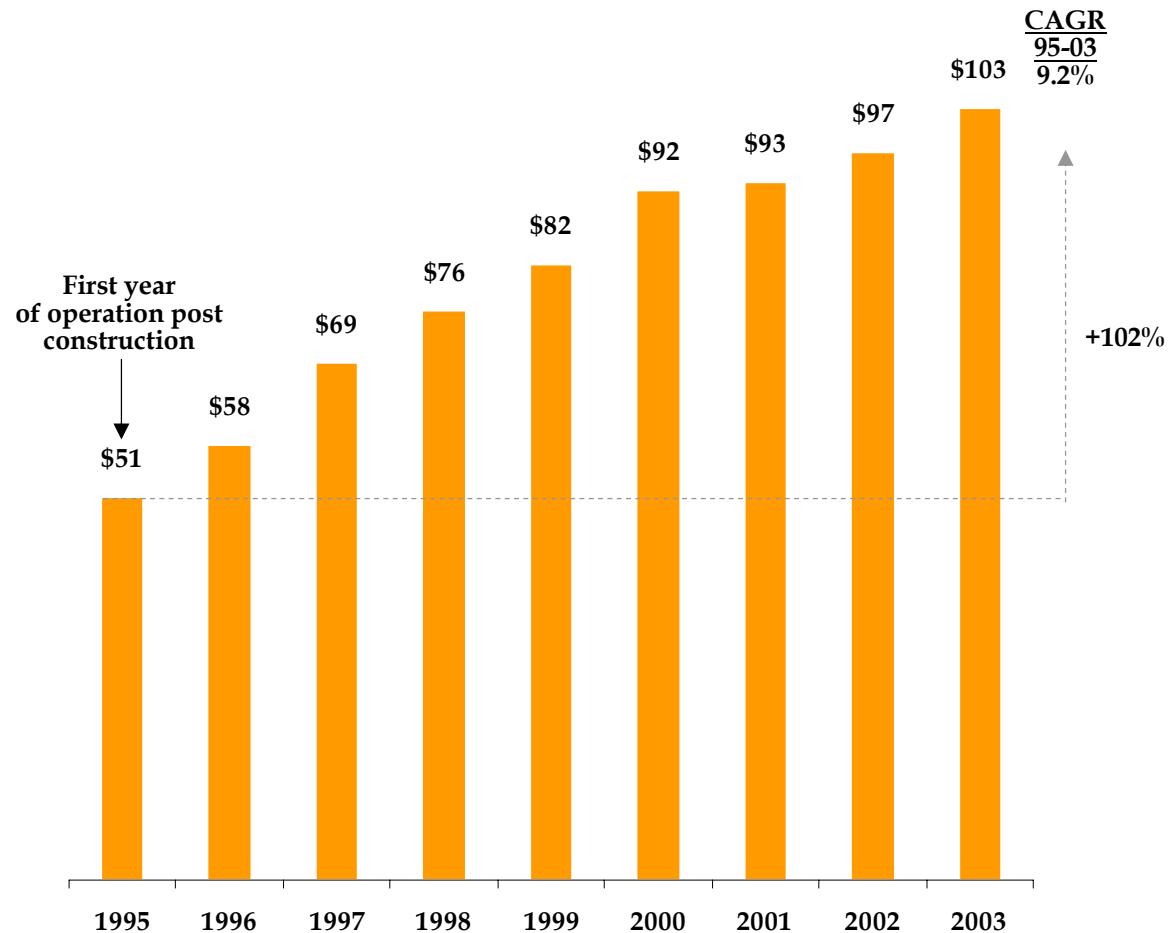
Shopping at a wholesale club requires consumer to change their behavior – therefore sales in a new club ramp up significantly over time

- **“It takes a while for consumers in a market to become educated about the existence of warehouse clubs, additional time to understand the values being offered by the format and finally, and most subtle of all, to perceive the tremendous amount of different and exciting in-and-out merchandise that flows through a warehouse over the course of a year.”** *Stephen Mandel, Analyst, Goldman Sachs, August 1989*
- **“This is a very hard concept to get across the people. We assumed that if we ran at a 9.5% margin, once the customer got into the warehouse he would be sold. It just didn't happen. We found that the small business operator would come to the warehouse and look around and not find any supplies basic to his business, so he'd go away and not come back. This completely defeats the purpose of the club... The group customer is just as difficult. We saw people coming in and finding an item or two where the price looked about the same as Target - never mind that the Target price was in a one-time circular - and they'd leave saying 'I can do just as well at Target. Another bunch of shoppers would come in with their regular shopping list. When they didn't find anything on their list, they'd walk out and we'd never see them again.”** *John Geisse, Chairman and founder, The Wholesale Club, November 1983*

SALES INCREASE OVER TIME FOR THE AVERAGE CLUB BUILT IN 1995

Because people have to learn to change their behaviour, average unit sales increases in the years following construction, doubling in the first eight years of operation

Average sales per club per year of units built in 1995
 \$, millions, FY1995-FY2003



SECTION 2: HISTORY OF COSTCO

This section looks at the history and development of Price Club and the wholesale club industry it spawned



“How does it feel to be universally acknowledged as the father of the membership warehouse industry?”

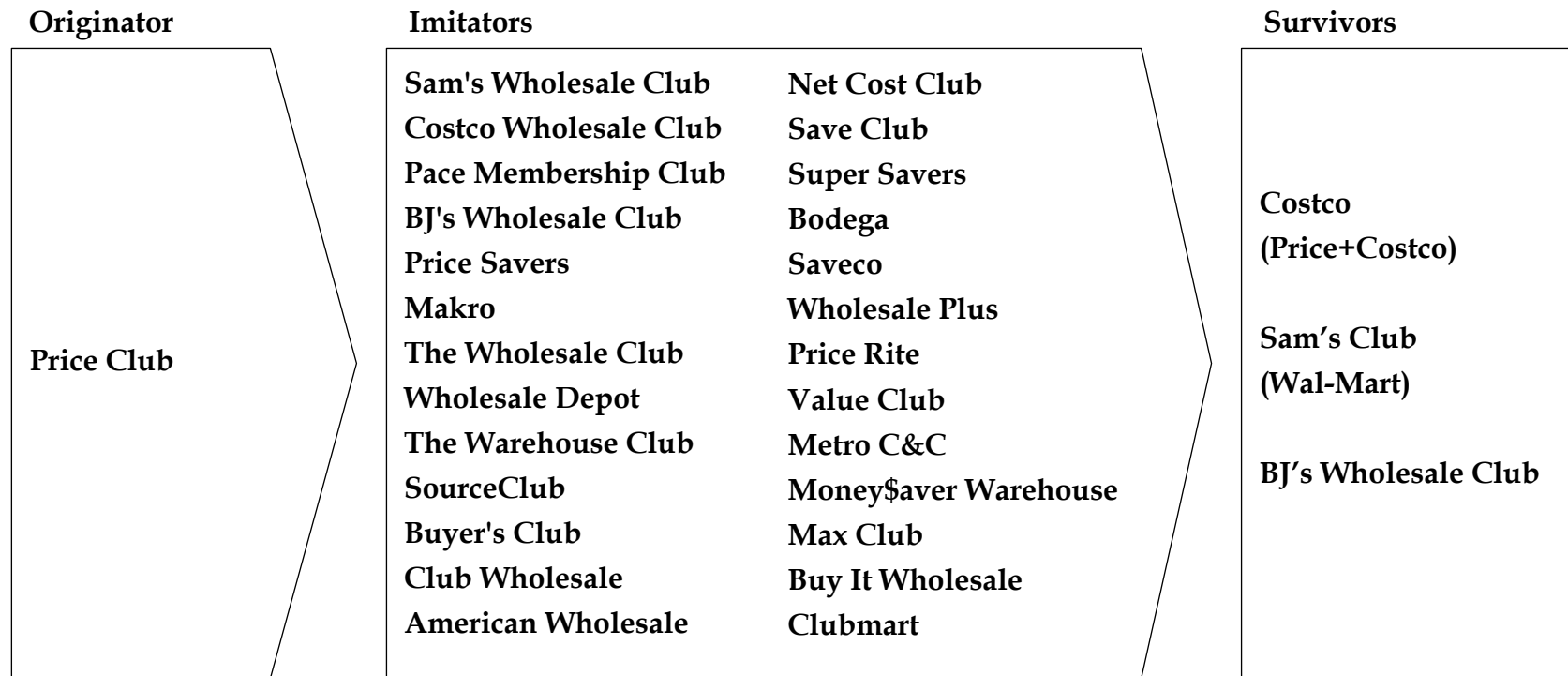
“I should have used a contraceptive.”

Sol Price, Founder, Price Club, February 1989

PRODUCT OF EVOLUTION

Costco is a product of a fierce evolution where over twenty-five clones were reduced to three remaining players

The evolution of the Wholesale Club format in the United States Model



WHOLESALE CLUB INDUSTRY TIMELINE

The wholesale club industry started in 1976 when Sol Price opened the first Price Club store, which attracted numerous imitators after Price Club went public in 1980

Price/Costco timeline

<p>1976</p> <p>Sol and Robert Price raise \$2.5 million and open the first Price Club in San Diego, CA</p> <p>Price Club loses \$750,000 in its first year of operations</p>	<p>1977</p> <p>Price Club posts a profit of \$5,000</p>	<p>1978</p> <p>Price Club opens second unit in Phoenix, AZ</p> <p>Price Club opens third unit in Santee, CA</p>	<p>1979</p> <p>Price Club opens fourth unit in Mesa, AZ</p>	<p>1980</p> <p>Price Club goes public at \$25 per share</p>
<p>1981</p>	<p>1982</p>	<p>1983</p> <p>Costco opens first unit in Seattle, WA</p> <p>Sam's Club opens first unit in Oklahoma City, OK</p> <p>Pace Club opens first unit in Aurora, CO</p> <p>Warehouse Club opens first unit in Niles, IL</p>	<p>1984</p> <p>Price Savers opens first unit in Salt Lake City, UT</p> <p>BJ's opens first unit in Medford, MA</p> <p>SuperSaver opens first unit in Shreveport, LA</p>	<p>1985</p> <p>First Costco hot dog cart</p> <p>Costco opens first Canadian unit in Vancouver, BC</p> <p>Carrefour of France buys 20% of Costco</p> <p>Pace launches PMW private label brand</p>

WHOLESALE CLUB INDUSTRY TIMELINE

The wholesale club industry went through a period of acquisition and consolidation in the late 80's and early 90's

Price/Costco timeline

<p>1986</p> <p>Price Club opens first Canadian store</p> <p>BJ's purchases 3 Metro Cash & Carry units in Chicago from Metro AG</p>	<p>1987</p> <p>Costco tests fresh meat and in-store bakery</p> <p>Sam's Club purchases SuperSavers (21 units)</p>	<p>1988</p> <p>Kmart purchases 51% of Makro USA from Makro SHV of the Netherlands</p>	<p>1989</p> <p>Kmart acquires Pace Club (61 units)</p> <p>Kmart purchases remaining 49% of Makro</p> <p>Wholesale Depot opens first unit in Bangor, ME</p> <p>Zayre spins off BJ's into separate company</p>	<p>1990</p> <p>Sam's Club buys Wholesale Club (29 units)</p> <p>Kmart acquires PriceSavers (17 stores)</p> <p>A&P announces plans to acquire 50% of The Warehouse Club (cancelled)</p>
<p>1991</p> <p>Costco announces plans to open in Spain or France with Carrefour</p> <p>BJ's introduces scanners at checkouts</p> <p>Sam's launches JV to open Club Aurrera in Mexico</p>	<p>1992</p> <p>Price Club opens first unit in Mexico</p> <p>Daiei opens first Duo's Club in Kobe, Japan</p> <p>Sam's Club reported looking at UK market</p> <p>Shoprite opens first PriceRite in Fishkill, NY</p>	<p>1993</p> <p>Price Club creates JV to enter UK market</p> <p>Sam's purchases Pace Club from Kmart</p> <p>Price Club and Costco agree to merge</p> <p>Mini-Costco tested in two markets</p>	<p>1994</p> <p>Price Enterprises (non-core real estate and other assets) spun off from Price Costco</p> <p>Nurdin & Peacock opens first Cargo Club in UK</p> <p>Wal-Mart opens Value Club in Hong Kong</p> <p>Costco opens in Korea</p>	<p>1995</p> <p>Sam's Club opens in Brazil and Argentina</p> <p>PriceSmart licenses first unit in China</p> <p>Name changes to Costco Wholesale</p> <p>First Costco Gas Station</p> <p>Costco launched Kirkland Signature private label</p>

WHOLESALE CLUB INDUSTRY TIMELINE

The mid 90's to today can be characterized as a period of international expansion

Price/Costco timeline

<p>1996</p> <p>Carrefour sells remaining 10.8% share in Costco</p> <p>PriceCostco buys Mexican units from Price Enterprises</p> <p>PriceSmart opens in Panama</p> <p>Sam's Club opens in China</p>	<p>1997</p> <p>PriceSmart spun off from Price Enterprises</p> <p>Costco enters Taiwan</p> <p>Costco introduces Executive Membership</p>	<p>1998</p> <p>Five Costco units open on the same day in Detroit</p>	<p>1999</p> <p>PriceSmart opens in Costa Rica, Dominican Republic, El Salvador, Guatemala and Honduras</p> <p>Costco opens first unit in Japan</p>	<p>2000</p> <p>Costco acquires Littlewood's 20% share in UK venture</p>
<p>2001</p> <p>PriceSmart opens in the Philippines</p>	<p>2002</p> <p>Costco Home test unit opened in Kirkland, WA</p> <p>PriceSmart opens in Aruba and Barbados</p>	<p>2003</p> <p>Costco executives visit Australia and New Zealand</p> <p>Sam's Club opens first store in Canada</p>	<p>2004</p> <p>Costco opens second Costco Home in Arizona</p>	<p>2005</p> <p>Costco opens in Australia</p>

ORIGIN IN FEDMART CHAIN

Price Club has its origins in FedMart, a concept Sol Price developed and later sold

- **“FedMart was a pioneering discount chain he had helped launch 22 years earlier, when he was a successful, 37-year-old San Diego lawyer. Price, whose dominating personality eventually made him the driving force behind FedMart, and three associates, who owned a wholesale watch company, first wanted to run the jewelry concession in one Fedco store, a closed-door Los Angeles discount chain. When they were turned down, the quartet raised \$50,000 and started FedMart in San Diego. Under Price's leadership, FedMart became the leading discounter in Southern California, a highly competitive market that saw a host of chains fail. FedMart's chance to expand from a regional chain to a national retailer came in 1975 when Hugo Mann, a West German retailing giant, made an offer for the \$350 million, 40-store company. Price agreed to the deal, but strong personality conflicts with Hugo Mann arose immediately. He was fired at the second meeting of the board.” *Discount Store News, August 1988***
- **“The concept dates back to 1954 when Sol Price organized the FedMart Corp., which began as a membership discount chain before abandoning the membership requirement in the mid-1960's. In the 1950's and 1960's, membership discounters were quite common. Price was FedMart's CEO until the retail company was acquired by West German businessman Hugo Mann in 1975. Both Sol and Robert Price remained as FedMart executives until much-publicized dissatisfaction with Mann's retailing approach resulted in their abrupt departure a few months later. While the Prices launched the Price Co. the following year, the 44-unit FedMart began losing money and closed its doors finally in 1982. Meantime, leases on 33 FedMart locations were acquired by the Target discount division of Dayton Hudson. Ironically, the store are becoming a direct Price Club competitor under the Target banner this year.” *Chain Store Age Executive, May 1983***
- **“I think Price realized he made a mistake when he got involved with the Germans. They didn't want him there because you can't have two leaders and Sol doesn't work well with anyone else--he has to be his own man... When FedMart rapidly slid downhill without Price, he was embarrassed by the debacle. It was his child and he felt hurt for the employees, the people he had worked with. I don't think he got any personal satisfaction from the FedMart failure.” *A 'former FedMart associate,' quoted in Discount Store News, August 1988***

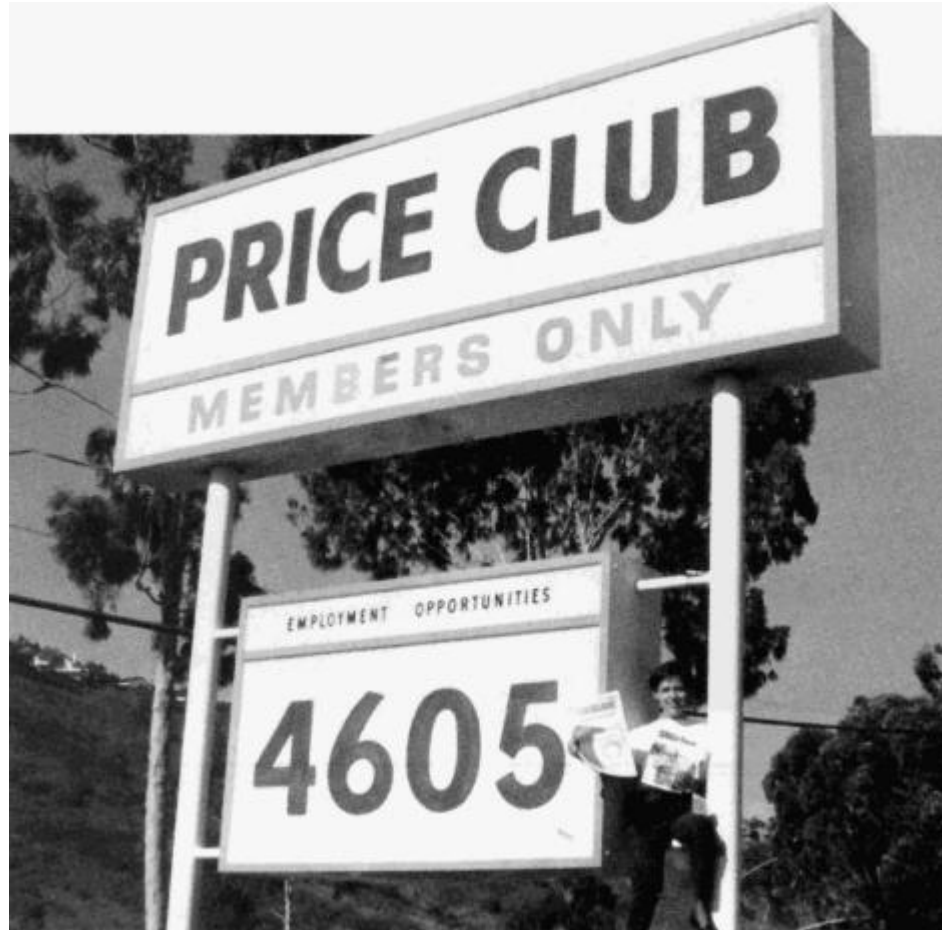
SOL PRICE DEVELOPS PRICE CLUB IN 1976

Sol Price opened the first Price Club in San Diego after leaving Fed-Mart

- "Sol Price first drew out the Price Club concept to a number of associates on a napkin in late 1975, shortly after he was fired from FedMart." *Discount Store News, August 1988*
- "Price's sterling reputation wasn't tarnished by the FedMart debacle. A few friends and associates bought a total of 475 shares, each worth \$5,000, to join Price and his son, Robert, in putting up the \$2.5 million seed money for the Price Club." *Discount Store News, August 1988*
- "Sol had an excellent name and everyone knew his reputation as an entrepreneur and a genius in retailing, I can remember seeing someone walk out of his office in tears of joy after Price allowed him to invest his money in the Price Club." *A 'source,' quoted in Discount Store News, August 1988*
- "It was terribly slow. Our sales were only about \$32,000 in our first week, and it got worse from there." *Sol Price, Founder, Price Club, July 2001*
- "Sol made us park our cars near the warehouse entrance to make it seem like there were lots of customers inside... For a while there, I wasn't sure we were going to make it." *Leslie Watson, early Price Club employee, July 2001*
- "When one becomes extremely knowledgeable about anything, it tends to inhibit one's ability to innovate. That's because a substantial number of unwritten rules and guidelines become programmed in a person's mind concerning things that can't be done. For example, if something that was attempted didn't work, it's not tried again. Ultimately, a knowledgeable executive has a whole list of things that can't be done. Along comes some young fellow, who's too stupid to know that, and as a result he does it." *Sol Price, Founder, Price Club, March 1989*

PRICE CLUB NUMBER 1

The first Price Club opened in an old aircraft hanger that was once owned by Howard Hughes, at 4605 Morena Blvd. in an industrial part of San Diego



PRICE PERSONALITY

Price's powerful personality formed the nucleus of the culture of Price Club

- **"Sam Walton and Sol Price came from right angles to one another in their approaches to life and work. Price likes to claim he read the Daily Worker instead of the Wall Street Journal... He was considerably more generous with benefits and wages than other discounters, Walton included. And, unlike Walton in those days, gave money to charities generously and often, through a foundation he created and to which he handed \$70 million."** *Bob Ortega, In Sam We Trust, 1998*
- **"Price is opinionated, but in the end a hard realist. The most persuasive element with Sol is reality; even though he has a strong ego, he is persuaded by logic and reality."** *Unnamed observer, San Diego Business Journal, November 1985*
- **"Price Club does not accept credit cards, because it's against my religion for people to go into debt to shop."** *Sol Price, founder, Price Club, November 1990*
- **"He's a tyrant - you have to be strong to stand up to Sol's towering personality. He may be difficult to work with, but I tell you the quality of honesty and integrity that starts at the top and permeates an organization is what gives it its stability and direction."** *Unnamed Price associate, quoted in Discount Store News, August 1988*
- **"If your point is that we don't get along with outsider partners, it could be well taken."** *Sol Price, Founder, Price Club, November 1985*
- **"A control freak."** *Lawrence Price, son of Sol Price (whom he sued for \$100 million), December 1988*

MEMBERSHIP FEES BUT RELAXED MEMBERSHIP CRITERIA

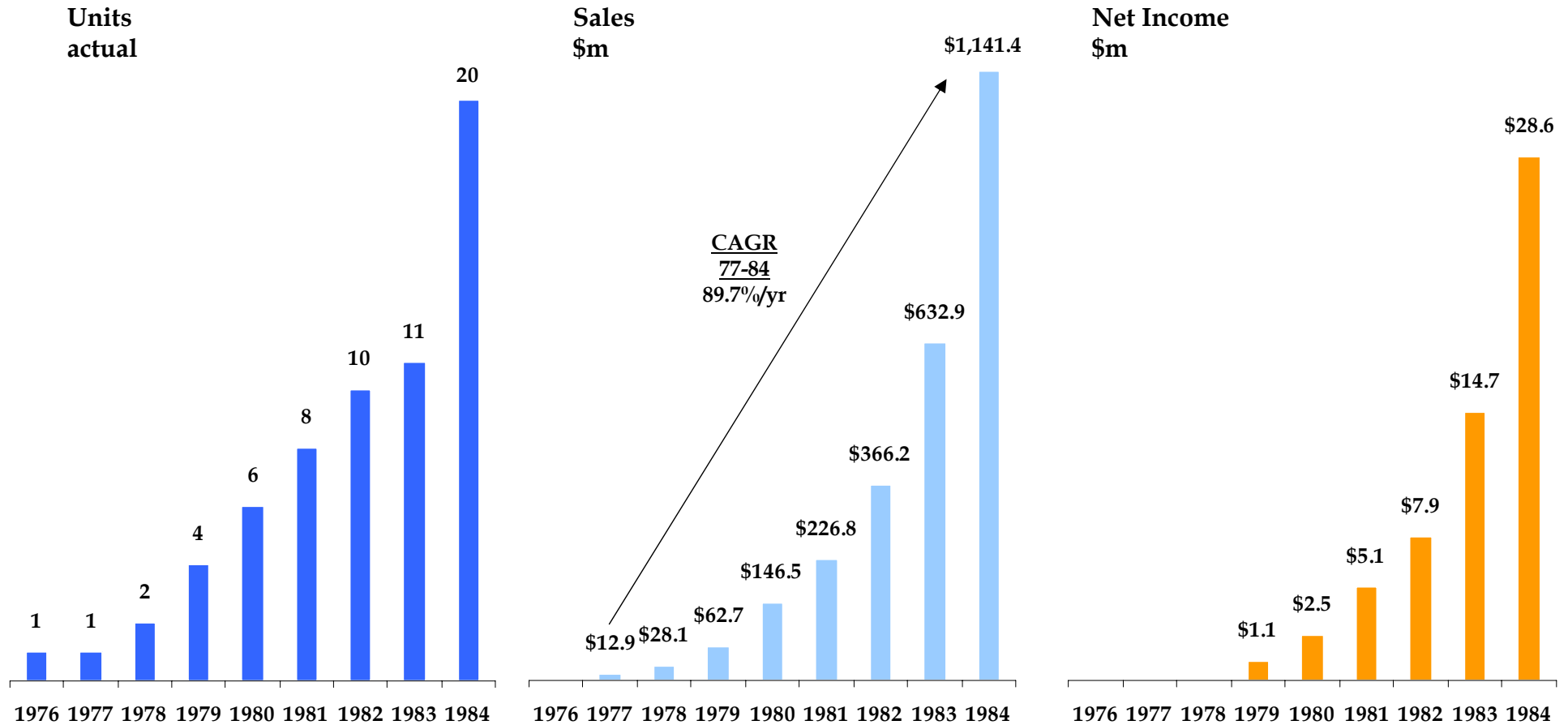
While initially open only to business customers, membership criteria were relaxed to allow members of select groups (e.g. government employees) to join

- **“To qualify for membership in Price Club, customers had to show proof of business activity such as a professional license or a resale permit. The proprietor of a bar could shop there for cigarettes to stock his shelves and toilet paper to stock the bathroom. A doctor could buy office stationery. So could a housewife doubling as an interior decorator.”** *New York Times, December 1988*
- **“Allowing group membership was the turning point. We opened in July (1976), allowed group members in September. If we hadn't done it that soon, we wouldn't have been around in December.”** *Robert Price, CEO, Price Club, March 1985*
- **“When Sol Price started Price Club in 1976, one of his first decisions was to invite small local businesses to join, because in his stores they could buy as cheaply as--or more cheaply than--they could from wholesalers. Very smart: Small business and nonprofits are now some of the country's most dynamic growth areas; today small merchants make up a third of Costco's membership and two-thirds of its sales. Priced at \$3.99 a pound, for example, Costco's rib eye steak is good enough and cheap enough that local restaurateurs shop at Costco stores alongside housewives and househusbands.”** *Forbes, August 1997*

HUGE GROWTH

Price Club achieved unprecedented sales and profit growth

Measuring Price Club's early growth
1976-1984



GOING PUBLIC ATTRACTS ATTENTION

When Price Club went public, the attention of the retailing world was suddenly focused on the wholesale club concept

- **“The force behind the new concept is Sol Price’s The Price Club, which grossed \$630m in nine stores in California and Arizona in fiscal 1983. Retailers took a hard look at the warehouse concept in late 1982, when Mr. Price made a public stock offering. Detailed reports circulated by securities analysts quickly became primers for potential competitors.”**
New York Times, November 1983
- **“Seven Price Club warehouses are expected to report more than \$100 million in sales this year, five times what they need to break even. That works out to \$1,000 per sq. ft., nearly 10 times the volume of the average discount store... That has got to excite any red-blooded American retailer.”** *Maurice Segall, President, Zayre, March 1985*

BRING IN THE CLONES

The success of Price Club attracted a raft of clones...

Other wholesale club start-ups

Fascia	Owner	Background	Opened	# at max (year)	Concept	Outcome
Buy It Wholesale	n/a (Utah)	n/a	1980	2 (88)	One 50,000 unit; expanded to two 100,000 units in 1986	Bankrupt 1987
Makro	SHV Holdings (Netherlands)	Global C&C Operator	1981	9 (89)	European-style cash & carry; 160,000sqft; 35,000sku; no membership fee Kmart acquires 51% in 1988; remainder 1989	Created JV with Kmart then merged with Pace
Sam's Wholesale Club	Wal-Mart (Arkansas)	Regional Discounter	1983	522 (03)	Copy of Price Club in the South First unit in Oklahoma City, OK	Still in operation (Public: WMT)
Costco	Jeff Brotman Jim Sinegal (Seattle)	Retailer + Ex-Price Club Executive	1983	430 (03)	Third generation retailer and ex-Price executive start chain of club stores; sell 20% of company to Carrefour in 1985	Merged with Price in 1993; still in operation
Pace Club	Henry Haimsohn	Former DIY chain exec and ex-Price empl.	1983	127 (93)	Started in ex-mattress factory by ex-Price employee; bought by Kmart 1989; merged with Makro JV; then acquired Price Savers	113 stores sold to Sam's Club; 14 closed in 1993
The Wholesale Club	John Geisse (Midwest)	Ex-Founder of Target Stores	1983	30 (90)	Membership focused on business	Acquired by Sam's Club in 1991
Warehouse Club	Walter Tenninga (Midwest)	Ex-Kmart Executive	1983	14 (89)	100,000sqft; 3000sku W.R. Grace (department store) acquired 50% A&P cancelled plan to purchase in 1990	Bankrupt 1995 citing competition
BJ's Club	Zayre	Department Store Operator	1984	152 (03)	Started by Zayre; spun off a separate company (including HomeClub home improvement stores) in 1989;	Still in operation (Public: BJ)

BRING IN THE CLONES

The success of Price Club attracted a raft of clones... (continued)

Other wholesale club start-ups

Fascia	Owner	Background	Opened	# at max (year)	Concept	Outcome
Metro C&C	Metro AG (Germany)	Global Leader in C&C	1984	3 (86)	Global leader in C&C stores opens three stores in Chicago; acquired by BJ's and all Chicago units later closed in 1991	Sold to BJ's
Price Savers	Pay'n Save (Utah)	Major Regional Supermarket	1984	24 (89)	Started by Pay'n Save supermarkets; later acquired by Kroger; sold to management 1989; sold to Pace	Bought by Pace Club in 1990
Super Savers	Regional Discounter (Louisiana)	Howard Brothers (Discounter)	1984	21 (86)	Started by regional discount chain Acquired by Sam's Club for \$36m	Acquired by Sam's Club in 1987
Wholesale Depot	Private Venture (Maine)	BJ's Club Founder	1989	9 (92)	60,000sqft; 3000sku; smaller clubs for smaller catchments;	Bankrupt 1994
Source Club	Meijer (Michigan)	Regional Supercenter Chain	1992	5 (93)	130,000 sqft; 3000-4000sku; no membership requirements; \$20 vs. \$25 fee	Closed 1993 Competition (Sam's Club)
Bodega	H.E. Butt (Texas)	Regional Supermarket Chain	1992	2 (92)	35,000 sqft; 3000sku; targeted at Hispanic community	Closed
Max Club	SuperValu (Midwest)	Major Grocery Wholesaler	1993	4 (95)	70,000 sqft; no fresh; higher racking; major wholesaler starts club; President Mark Mers, ex-Price, Costco and Price Savers executive	Closed 1995
Price Rite	Wakefern/ (New Jersey)	Major Grocery Wholesaler	1992	1	Pilot project; empty 30,000sqft supermarket; 1,000sku; mini-wholesale club free membership; Fishkill, NY	Closed

BRING IN THE CLONES

The success of Price Club attracted a raft of clones... (continued)

Other wholesale club start-ups

Fascia	Owner	Background	Opened	# at max (year)	Concept	Outcome
Wholesale Plus	David Kenney (Florida)	Former President discount chain	1983	1 (88)	Former president of Jefferson-Ward discount chain offering no-frills discount shopping with only brand names	Bankrupt 1988
Saveco Sales	Investors (CA)	Small Supermarket Operator	1987	2 (87)	80,000sqft unit; converted to supermarket in 1988; stiff competition cited	Converted to supermarket
Clubmart	Eugene Ferkauf + others	Founder of Korvettes Discount	1983	1 (84)	Founder of E.J. Korvettes disount chain Membership club; name brands with little markup in a luxury setting "marble floors"	Purchased by Wags Stores 1985
Buyer's Club	Ken Bagus (Colorado)	n/a	1985	6 (89)	Focused on the Colorado market	Bankrupt 1989; 1 unit sold to Costco
Club Wholesale	Investors (Idaho)	n/a	1984	6 (89)	3,500 sku; acquired by Investment bank 1988; some converted to office products format 1990	Liquidated 1990
American Wholesale	Investors (Texas)	n/a	1985	6 (89)	Based in Richardson, Texas; expanded into Chicago then left	Bankrupt 1989
Net Cost Club	Investors (Pennsylvania)	n/a	1985	1 (89)	Based in Montgomery, Pennsylvania	Bankrupt 1989
Save Club	Behfar Inc. (California)	n/a	1985	2 (89)	Based in Concord, California	Bankrupt 1989

BRING IN THE CLONES

Including a number of international wholesale clubs

Other international wholesale club start-ups

Fascia	Owner	Background	Opened	# at max (year)	Concept	Outcome
Cost-U-Less	Private Venture	n/a	1989	11 (03)	30,000sqft; 25,000sku no membership fee; 14-16% margins; target islands: Hawaii, Guam, St. Thomas, St. Croix, Samoa, Fiji, Curacao, St. Maarten, New Zealand (failed)	Still in operation (Public: CULS)
Real Canadian Wholesale Club	Loblaw (Canada)	Largest Canadian Retailer	1991	33 (03)	Major Canadian retailer launches Club in response to growth of Costco in Canada	Still in operation (Public: L.CA)
PriceSmart	Price/Costco Spinoff	Sol & Robert Price	Spun-off 1994	44 (03)	40,000-50,000sqft; \$25 membership fee; targeting Central America	Still in operation (Public: PSMT)
GrandMart Warehouse Club	Gregory & Patrick Ng + others	Two brothers	1993	8 (95)	Introduce American-style warehouse club to Hong Kong; plans to spread to China HK\$40m sales in first 2 years	Liquidated 1998
Kou's Club	Daiei Inc. (Japan)	Major Japanese Retailer	1993	2 (94)	Japan's largest retailer launched Club concept in Japan in response to expected Costco arrival; 8,000skus (70% GM; 30% food)	Tried to sell to Carrefour; still in operation (FY03)
Kim's Club	New Core	Department Store Chain	1993(?)	15 (02)	New Core department store chain launches warehouse club concept in Korea; \$800m in turnover in FY2003	"Difficulties" WMT & CARR bidding (2002)
Value Club	Wal-Mart and C.P. Pokphand Joint-venture	Major Asian agro-industrial conglomerate	1994	3 (95)	Mini version of warehouse club; 10,000-20,000 sqft; JV ended and Wal-Mart expanded into China	Wal-Mart exited JV in 1995
Cargo Club	Nurdin & Peacock	Traditional Wholesaler	1994	3 (95)	UK wholesaler; In response to arrival of Costco and Price "did not understand wholesale clubs"	Closed; sites sold to Sainsbury

PROUD TO BE A CLONE

The clones showed no shame in admitting the fact

- **"I don't mind being a clone."** *Walter Teninga, former vice chairman of K mart Corp, former Price Club partner, founder The Wholesale Club, March 1985*
- **"We're the clone of clones."** *Jeffrey Brotman, Chairman, Costco Wholesale Corp, September 1985*
- **"We are pretty much following Sol Price's formula. There is no need to re-invent the wheel."** *Lamont Bean, Chairman, Price Savers Club (Pay 'n Save), November 1983*
- **"Price Club's enormous success has spawned myriad 'clones' that are systematically staking out market all over the country in an effort to be the first in each area to establish this exciting new wholesale-retail distribution concept."** *Joseph Ellis, Analyst, Goldman Sachs, March 1985*

COSTCO: CLONE OF CLONES

Costco, started by Jeffrey Brotman and Jim Sinegal, was the most successful clone

- **“From the company's inception, Jeffrey H. Brotman has served as chairman of Costco, and James D. Sinegal has been president. While Sinegal had a background in membership warehouses and retail chains (having been mentored by Sol Price, the founder of Fed Mart and Price Club), Brotman was an executive of an oil exploration company and cofounder of a group that operated a chain of apparel stores. In 1985 Costco became a publicly owned company, and in 1993, Costco merged with Price Club to become Price/Costco, Inc. In August 1999, the company reincorporated and changed its name to Costco Wholesale Corporation.”** *Costco profile, Infotrac, March 2004*
- **“A third generation retailer, Brotman and his brother Mike, while engaged in other careers, started several women's and men's clothing operations, Jeffrey Michael, Brotman's and Bottoms, and now have 25 stores. Those are run by professional management. In 1982, Brotman began to study the Price Club operation. He moved his family to San Diego for a six month period with the intention of evaluating that then semi-privately owned business to determine if it really was as good as it appeared upon observation. It was during that period Brotman met Sinegal, whom he regards as much of an expert in the warehouse concept as Sol Price, chairman-founder of the Price Co.”** *Home Furnishings, September 1985*

JIM SINEGAL: THE PRODIGAL SON

Jim Sinegal learned retailing under Sol Price and later surpassed his teacher

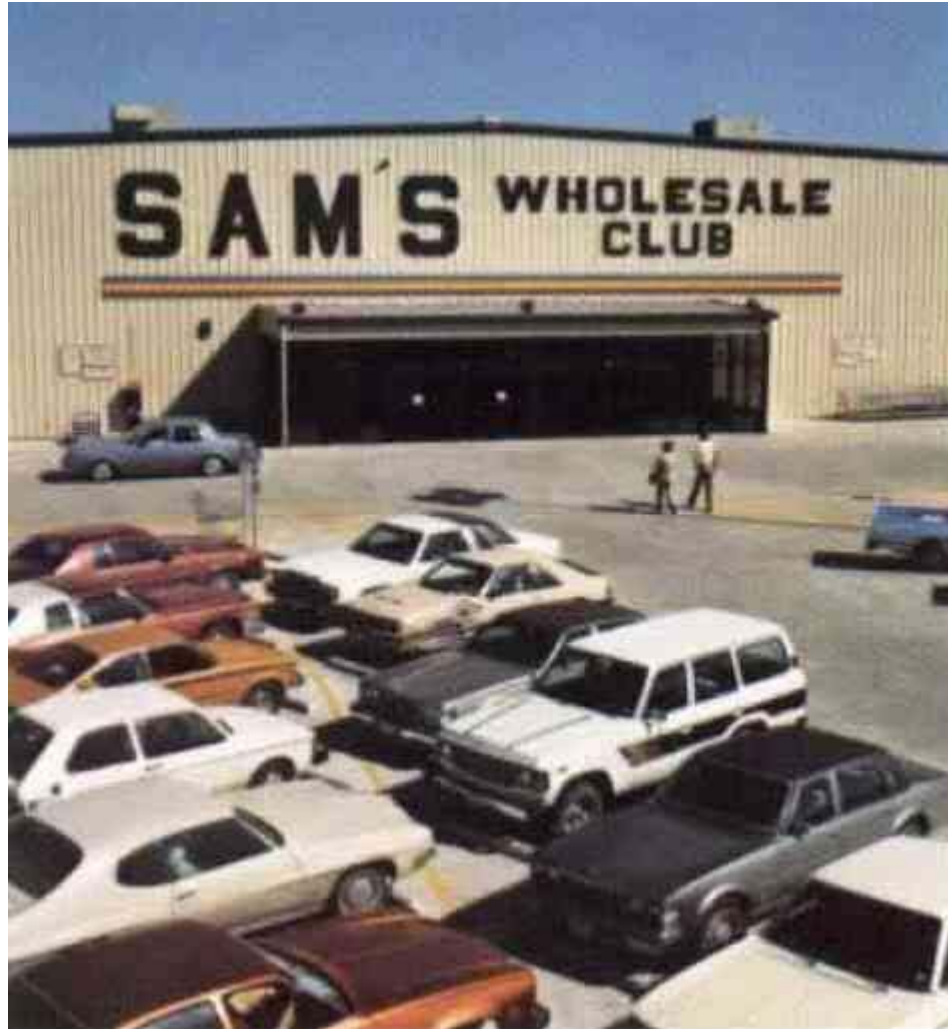
- **"In 1954, when he was a student at San Diego State University, Sinegal began working part-time for Sol Price's Fedmart, the pioneer supercenter chain. All told, he spent 24 years under the older retailer's wing, finally as executive vice president at Price Club. But Sinegal needed his head. After a spell on his own, he was introduced in 1983 to Jeffrey Brotman, scion of a Seattle retailing family, recruiting him to open a regional warehouse chain. Within two years Costco was in California, territory of Price Club. Later, the original warehouse took second fiddle in a merger."** *Forbes, August 1997*

- **"Sinegal started with Sol at FedMart in 1955 and became executive vice president of merchandising operations and then subsequently joined Sol in the Price Club. He left the Price Club and started his own business aimed at vendors and special packaging for warehouse club operations. I persuaded him to move to Seattle for our Costco effort which hopefully would duplicate the Price Club success. We felt the northwest was virgin territory for this concept and in fall of 1982 we developed our business plan; raised venture capital financing of \$7.5 million primarily from people we had done business with in the past. We closed that financing with about 50 investors in spring, 1983."** *Jeffrey Brotman, Chairman, Costco, September 1985*

- **"We're identical to the Price Club primarily because so many of our management personnel come from that operation. Everyone has gone to San Diego and copied the Price Club. But it's one thing to copy it physically and another to copy it mentally. If you don't have the mental belief that you're a wholesaler, then it becomes a self-fulfilling prophecy and you begin to act like a retailer. Most of the other warehouse operators come from the retail genre and consequently when you walk into a food section you see three or four different mayonnaise brands, several consumer sizes and so on. The TV section shows 28 TVs and 15 VCRs. Then they go into newspaper and TV advertising; take locations in busy intersections; build upgraded stores and membership criteria becomes nonexistent. If you ask these operators 'Are you a wholesaler?' they reply: 'Of course;' and that's a lie. If you compare Costco and some of these other operations, it's like the difference between chicken livers and chicken spit. You can't take soap and wash 30 years of retail experience out of a man's mind."** *Jeffrey Brotman, Chairman, Costco, September 1985*

SAM'S CLONE

Sam Walton's Wal-Mart launched Sam's Club in 1983



“BORROWED”

Sam Walton “borrowed” the idea for Sam’s Club from Sol Price

- **“I guess I've stolen - I actually prefer the word 'borrowed' - as many ideas from Sol Price as from anybody else in the business.”** *Sam Walton, founder, Wal-Mart, Made In America autobiography, 1992*
- **“He came out to look at a Price Club, and he was very complimentary.”** *Sol Price, November 2003*
- **“Twenty-five years ago I saw your Fed-Mart store in Houston, and I knew it was a big thing, but I didn’t have the money to begin in a big town, so I went back to my small town and started there. Now I have 350 stores, I’m worth \$700 million, and I’m on the New York Stock Exchange - and it’s all thanks to you.” “Well, then, don’t you think I’m entitled to a finders fee?”** *Sol Price, quoted in In Sam We Trust, 1998*
- **“Recognizing the ever-changing retail environment, we also plan to test a new discount store vehicle in the form of a membership warehouse club.”** *Sam Walton, Chairman, Wal-Mart Annual Report 1983*

SUCCESS WITH THE CONCEPT

Wal-Mart achieved strong growth with its new concept

- **“We're excited about the prospects. We're running ahead of our projections, and the return on investment is as good as in our traditional business.”** *Jack Shewmaker, Vice Chairman, Wal-Mart, December 1984*
- **“Sam's Wholesale Club, a wholesale membership store, designed to operate at very low margins, has proven to be a very successful format for the larger metropolitan markets in our trade territory and will be a planned aspect of our future growth.”** *Wal-Mart Annual Report 1984*
- **“Sam's Wholesale Club sales were \$1.678 billion, an increase of 116% from \$776 million a year ago, which followed a sales increase of 250% in the preceding year... We believe this new vehicle offers the Company expanded growth potential for many years.”** *Wal-Mart Annual Report 1987*
- **“It's one of the most exciting concepts to come along in many years that is truly different. Our chairman, Sam Walton, is always studying other forms of retailing and naturally was interested in the concept based on the figures Price was producing. We describe these things as a wholesale-retail, cash-and-carry, membership-only warehouse. Although on the front end that doesn't sound particularly appealing to the shopper, when they look over the merchandise assortment, they get excited about that. Our target customer is really the small business owner-operator. We're offering them the opportunity to buy as little as they want at the best price. It does require high turnover and higher volume to make these things possible.”** *Ronald Loveless, SVP, Sam's Wholesale Club, March 1985*

LESSONS FROM SAM'S

Wal-Mart learned a number of important lessons from Sam's Club

- **"The impact that resulted from opening three Sam's as a test in 1983 - just six short years ago - has shown up in a variety of ways: (1) It paved the way for Wal-Mart to enter the retail food business through its experimental Hypermart USA and Wal-Mart Supercenter ventures; (2) It eased the discounter's entry into more urban markets; (3) It helped the company maintain its torrid financial growth... Sam's has also brought important benefits to the operational area--teaching Wal-Mart how to handle merchandise more efficiently. Goods sent to Sam's are premarked, palletized and commodity packed, with the merchandise moved by mechanical devices, rather than by hand. This experience leads to improvements in productivity and efficiency, and the savings fall to the bottom line." *Discount Store News, December 1989***

SAM'S ACQUISITIONS

Wal-Mart made a number of acquisitions to strengthen Sam's Club

Wal-Mart wholesale club related acquisitions
1987-1994

Acquisition	Year	# of Stores	Details
Super Saver Wholesale	1987	21	Wholesale club stores located in South
The Wholesale Club	1991	28	Wholesale club stores located in Midwest
Pace Membership Warehouse	1994	113	Pace was originally acquired by Kmart in 1989 and merged with Kmart's Makro USA JV, which then acquired Price Savers; Kmart liquidated the business and sold the "right to operate" in 113 former Pace locations to Sam's Club

THE CONSTANT THREAT OF CANNIBALIZATION

Sam's struggled to justify cannibalizing other Wal-Mart stores

- **"The biggest thing with Sam's was that it didn't have a free hand to compete with Wal-Mart. There was this fundamental thing where they didn't want to kill Wal-Mart. The other problem was that Sam's didn't cater to the higher class of people that Costco did."** *Sol Price, Founder, Price Club, November 2003*
- **"One of the best things Costco has going for it is the fact that Sam's is affiliated with Wal-Mart where the culture says low price rules. Sam's wants to do everything on the cheap side, and then it is reluctant to do anything that might be detrimental to Wal-Mart's business. Those attitudes are changing at Sam's, but until it develops its own identity, Sam's will be chasing a moving target by copying Costco, just as other discount stores have never succeeded in copying Wal-Mart."** *Maggie Gilliam, Wal-Mart newsletter publisher and former Wall Street analyst, June 1998*
- **"There are few more futile activities that I can think of than trying to drive sales at a club unit from \$100 million to \$150 million. It's much better to open new clubs and cannibalize your sales."** *David Glass, Chairman, Wal-Mart, March 1993*

STRONG GROWTH, STRONG COMPETITION

The wholesale club industry went through a period of massive growth

- **"The future is bright. We have had the opportunity of facing competition and we have become much stronger."**
Thomas Grimm, President, Price Savers, February 1985
- **"We see the warehouse club industry as being in only the early to middle stages of its development, with enormous potential ahead for its major participants."** *Joseph Ellis, Analyst, Goldman Sachs, March 1985*
- **"Price is probably the most phenomenal business I've run across in 18 years of following retailing."** *Bo Cheadle, analyst, Montgomery Securities, March 1989*
- **"It's the same old story, with a new set of characters. Someone comes up with a new retail concept. When it succeeds, others imitate and adapt the idea. Once several companies grow large enough, some begin acquiring smaller chains as a shortcut to entering new markets and possibly to eliminate competition. Eventually the industry is dominated by a handful of large firms. Department stores have gone through the cycle, as has the discount business. Now the consolidation that has taken place throughout retail is hitting the warehouse/wholesale club industry."** *Chain Store Age, February 1991*

FIRST TO MARKET

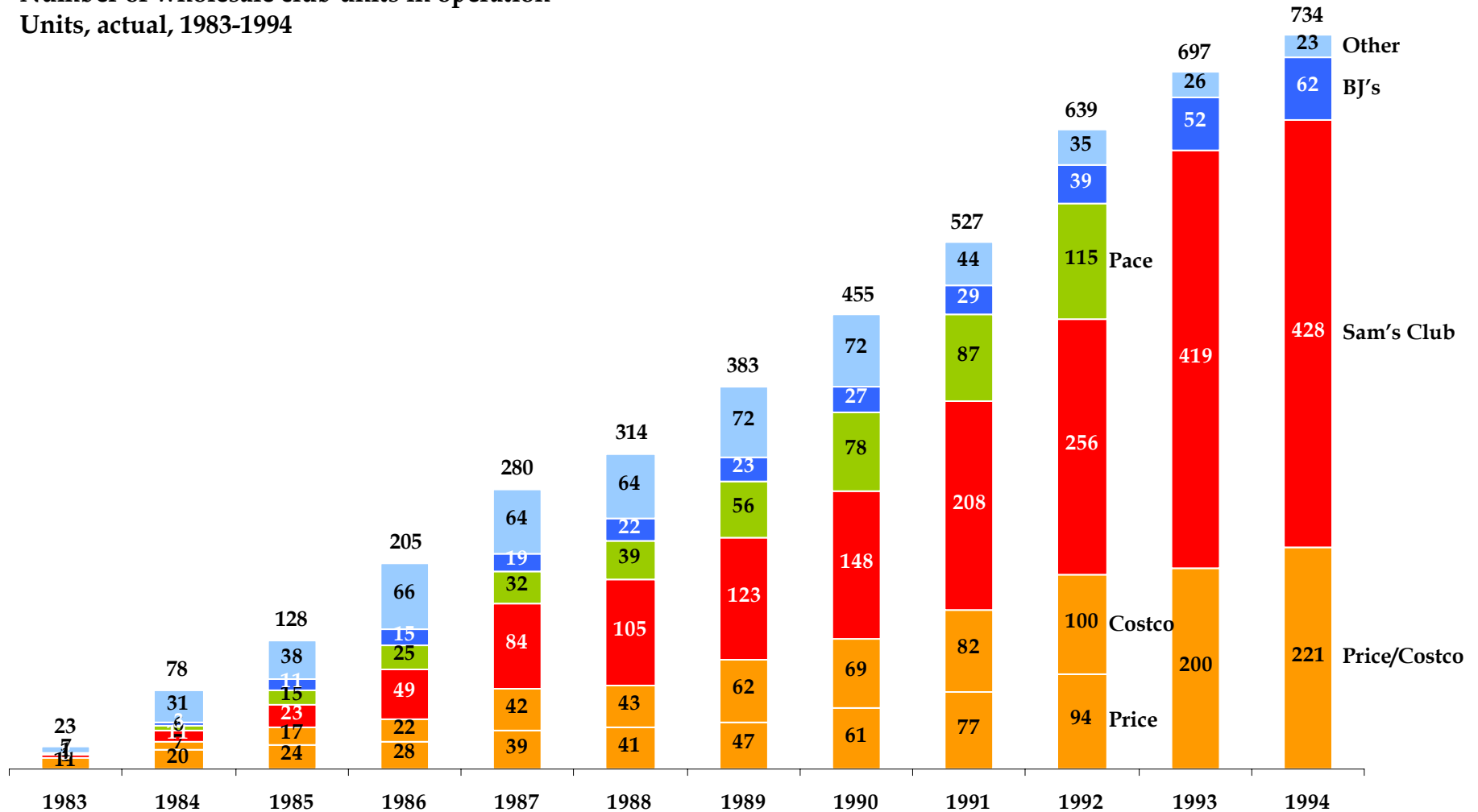
Chains believed they needed to be first into a market as customers would be unwilling to pay to join a second club

- **“Everyone knows the right thing to do is grow in clusters. But they're afraid of other people getting to markets before they do, so they do what in their hearts they know is dangerous... A lot of people have spread themselves thin. Now they're going to have to live with that.”** *Kenneth Pearlman, analyst, Shearson Lehman, February 1985*
- **“In this business market penetration is not that important. Getting to markets first is more important.”** *Mervyn Weich, President, BJ's Wholesale Club, February 1985*
- **“The enormous sales volume Price Company has been able to pump out of some of its units makes the strongest case for growing in clusters. As just about everyone in the industry will admit, Price has succeeded best where it has established strong name recognition, where consumers have come to know and understand this new concept. It is difficult to do that in markets where a company is operating just one unit.”** *Chain Store Age, February 1985*
- **“There seems to be a big premium on being the first warehouse club in a market. That's why the consolidation has been happening.”** *Stacy Dutton, analyst, Morgan Stanley, February 1991*

UNITS NUMBER GROWTH

The wholesale club industry grew from 23 units in 1983 to 734 units in 1994

Number of wholesale club units in operation
Units, actual, 1983-1994



COMPETITION & CONSOLIDATION

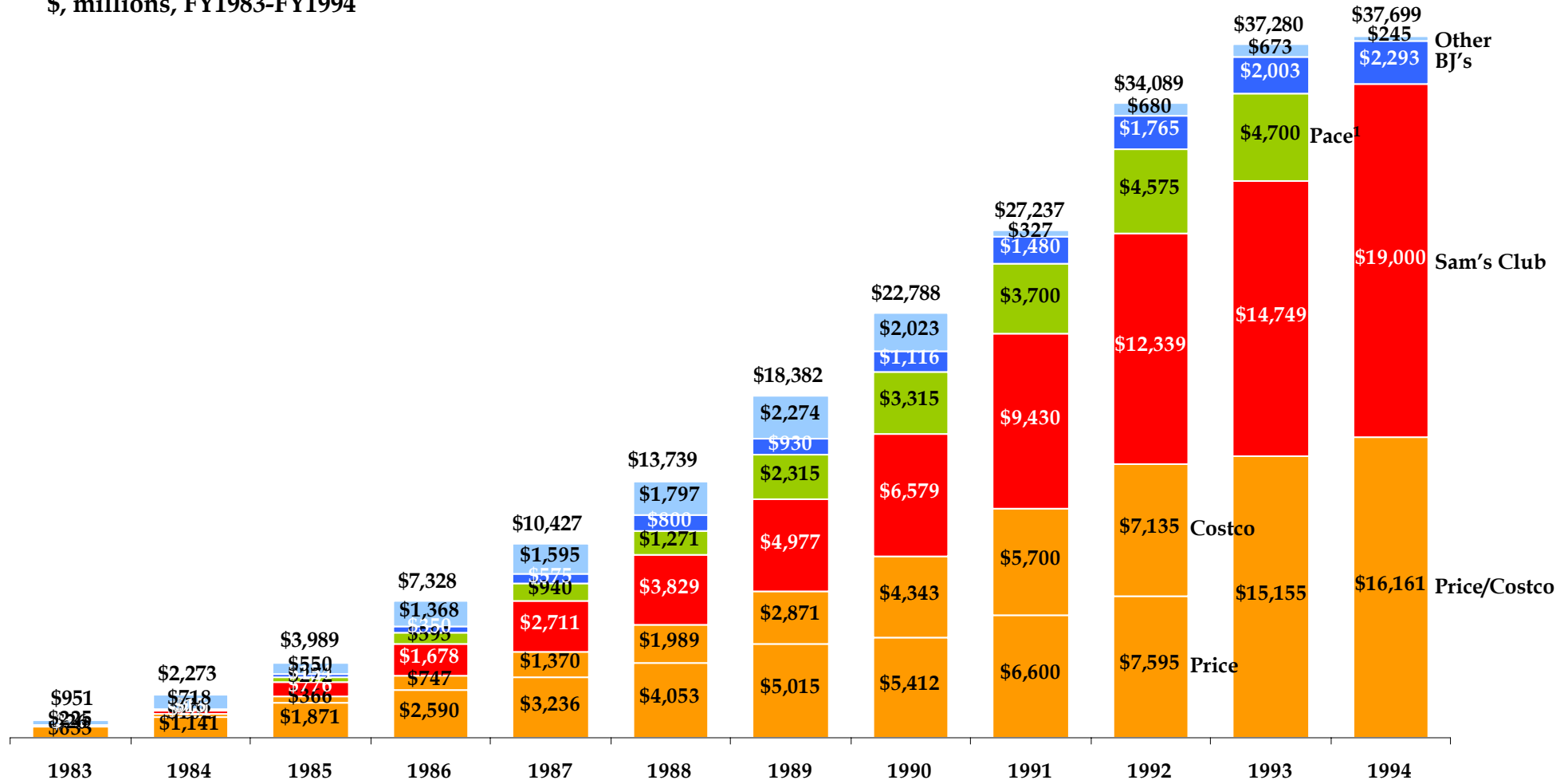
Rapid growth and strong competition ultimately took its toll

- **"In virtually every market we're competing with someone."** *Jeffrey Brotman, CEO Costco, March 1986*
- **"With a 9% gross margin, there's not much margin for error. We'll see some consolidation."** *Walter Teninga, founder, The Wholesale Club, March 1985*
- **"What has happened, though, is that the competition became unbelievable, and in many markets which could support one or two clubs, three or four opened."** *Kurt Barnard, president, Barnard Enterprises, June 1993*
- **"These markets are not strong enough to support two warehouse outlets. We are about to find out who is better."** *Jeffrey Brotman, Chairman, Costco, November 1983*
- **"When you have a new format, you'll have a number of companies wanting to take advantage of it. Ultimately, the weaker companies go by the wayside or are bought by other firms."** *Joseph Kornwasser, Partner, Kornwasser & Friedman, February 1991*
- **"The technique is to open one warehouse and announce plans for 10 others to try to keep everyone else out of your target cities."** *Lamont Bean, Chairman, Pay 'n Save, November 1983*
- **"Events of the past two years have clearly demonstrated why Price Club remains the undisputed leader in the industry... It's withstood the onslaught of nearly 20 competing clubs in the southern California market, as well as its own cannibalizing warehouse openings. Through it all, Price has maintained positive comparable-warehouse sales because of its high sales-per-warehouse base. Even in its newest East Coast warehouses, Price has been able to generate volumes ranging from \$60-80 million a year."** *Steve Mandel, analyst, Goldman Sachs, September 1988*
- **"It started off with the warehouse club revolution, then it was evolution, then market pollution and prostitution. Now we are in the mode of reconstitution."** *Mervyn Weich, ex-President, BJ's Club, Industry Observer, November 1995*

INDUSTRY SALES GROWTH

Turnover of the wholesale club industry grew massively from just under a billion in 1983 to \$37.7 billion in 1994 – a compound growth rate of 40% per year for eleven years

Sales of wholesale club operators
\$, millions, FY1983-FY1994



PRICE COSTCO MERGER

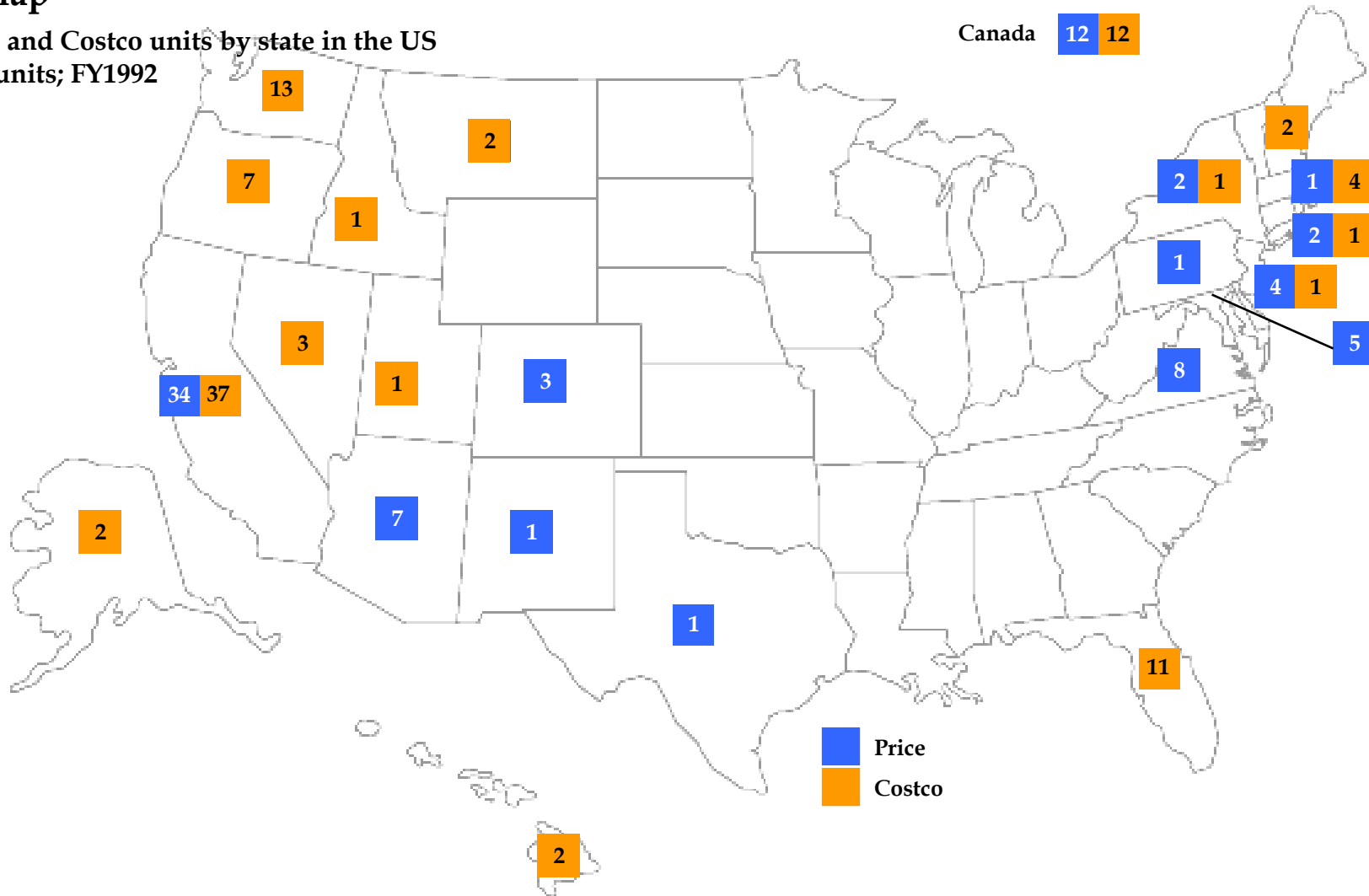
Price Club and Costco announced plans to merge in 1993

- **"Sam Walton: "How to keep a big business vital and free of kickbacks and the like?" Sol Price: "You should shuffle people out of jobs. And you know where you should start? With yourself!""** *Sol Price, quoted in In Sam We Trust, 1998*
- **"We were good at innovating, but when it came to expanding and controlling, we weren't so good. Now, Jim has done a pretty damned remarkable job. He puts a great emphasis on quality and has moved into the food business and other new lines. We were very good at creating, but Jim was very good at developing."** *Sol Price, Founder, Price Club, November 2003*
- **"Sometimes people who start a concept end up where the thing must be taken over by people who focus on the management and the maintenance."** *Sol Price, Founder, Price Club, August 1997*
- **"No two merchandising companies could be more alike in terms of their merchandising philosophies, corporate cultures, determination to offer high quality products at great value to the consumers and commitment to their employees."** *Joint Price/Costco statement, June 1993*
- **"A bold, blockbuster transaction which will result in strong competition for Sam's and will also create a new international retailer whose sales volume will make it the sixth largest retailer in the U.S."** *Michael Exstein, analyst, Kidder Peabody, October 1993*
- **"Under the proposed merger agreement, shares in the new company will be issued on a basis of 2.13 shares for each common share of Price Co. and 1 share for each common share of Costco Wholesale. Shareholders of Price Co. will get 48 percent of the merged company while shareholders of Costco will get 52 percent."** *Daily News Record, June 1993*
- **"It's what is needed to ensure the survival of both companies. By combining their operations, Price and Costco will dominate California and the West Coast and use that as a base to expand."** *Michael Exstein, analyst, Kidder Peabody, June 1993*
- **"In terms of size and buying power, there was a motivation to improve our purchasing power to better compete."** *Richard Galanti, CFO, Costco, July 1997*

PRICE & COSTCO UNITS ONE YEAR PRIOR TO 1993 MERGER

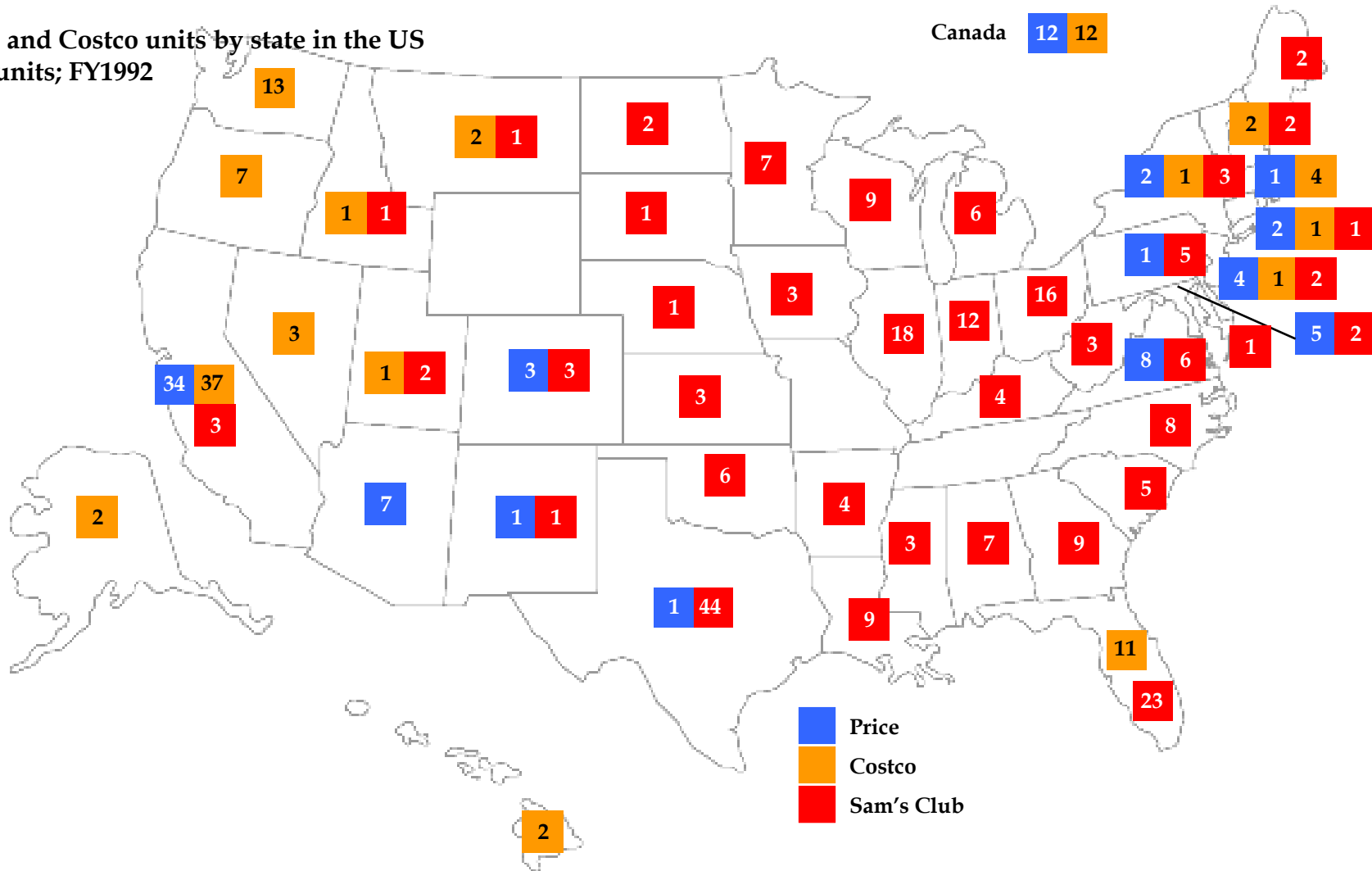
One year before the merger Price Club and Costco clearly had a strong fit and were beginning to overlap

Price and Costco units by state in the US
of units; FY1992



UNITS ONE YEAR PRIOR TO MERGER - INCLUDING SAM'S
 However, Sam's Club also had a good fit with either chain

Price and Costco units by state in the US
 # of units; FY1992



THREAT OF A WAL-MART TAKEOVER

The threat of a takeover by Wal-Mart/Sam's Club was one of the reasons for the merger

- **“As a result of intensified competition, both Price and Costco approached, or were approached by, a number of other entities, including retailers utilizing a warehouse club merchandising format and other retailers, regarding the possibility of a sale, acquisition or some form of combination. Neither Price nor Costco engaged in discussions with such third parties that advanced beyond a very preliminary stage.”** *Price/Costco Joint proxy statement, October 1993*
- **“Trade observers said the interested third parties included Wal-Mart and Kmart, each looking to strengthen their own clubs, Sam's Club and Pace Membership Warehouse, respectively. The Price Club also tried to boost its presence in the Northeast by a deal with Waban for its BJ's Wholesale Club.”** *Discount Store News October 1993*
- **“Wal-Mart, Sam's Club parent, could acquire Costco without diluting its 1994 per share earnings... We think both Wal-Mart's and Costco's management and boards were keenly aware of this potential, and we wonder if Costco's management heard Wal-Mart's footsteps.”** *Patrick McCormack, analyst, Dean Witter, July 1993*
- **“Sinegal and other Costco executives have a long relationship with Sol Price. They worked for Price at the Price Club and at his previous retailer, Fed-Mart. Because of that relationship, Price felt hurt when Sinegal and other executives left the Price Club to launch Costco, a former Price Club executive said. But Price and Sinegal may have preferred that their company remain part of an "extended family," rather than separately face Sam's Club and perhaps be acquired by Wal-Mart.”** *Discount Store News, October 1993*
- **“San Diego already is one of the most saturated club markets in the country. That Sam's is willing to open in the belly of the beast shows they have no fear. The Price/Costco merger could help the other two keep Sam's at bay.”** *Charles Anderer, Editor, Club News, June 1993*

THE SPLIT

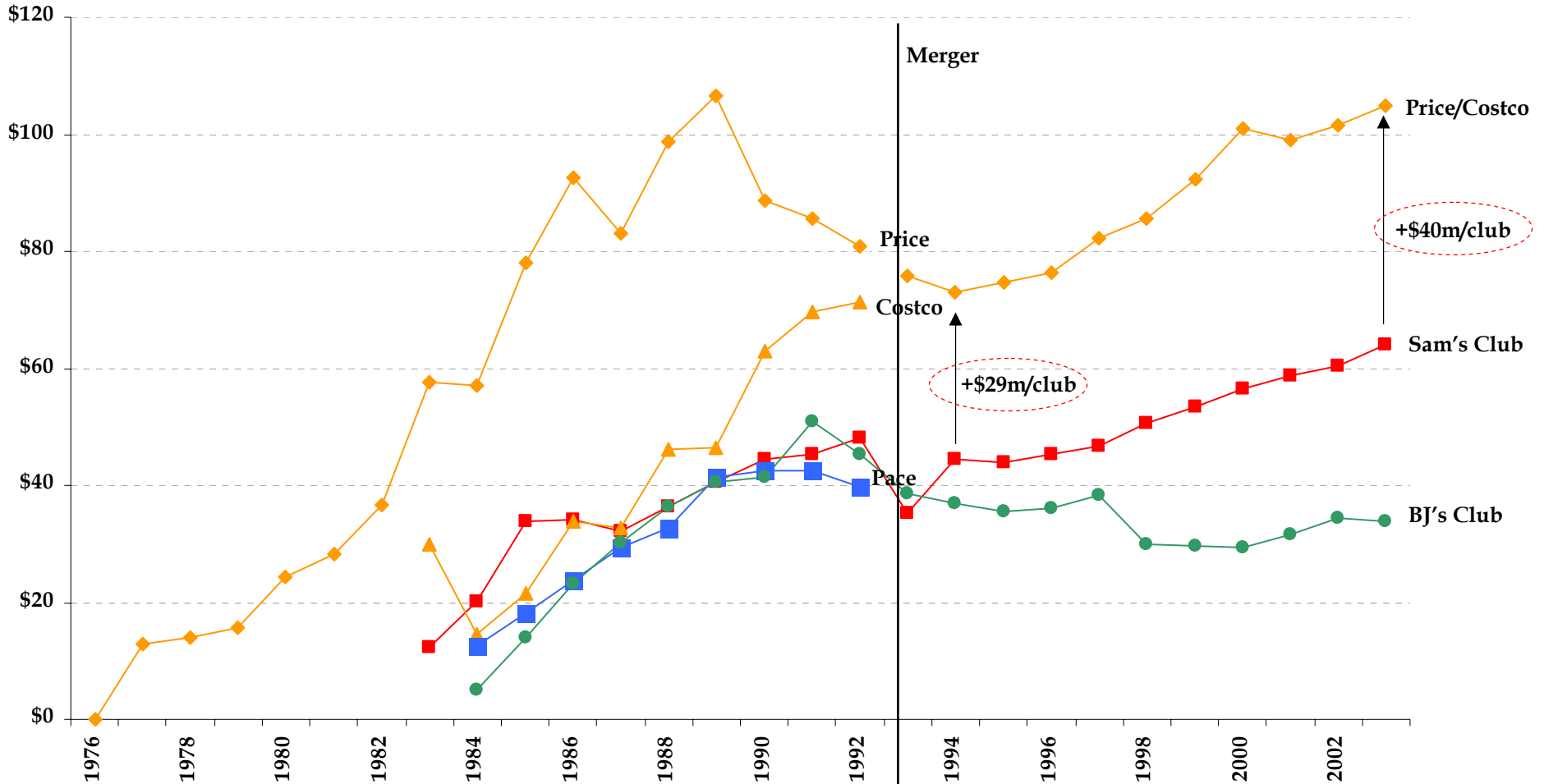
The merger soon ran into difficulties and Price Enterprises (later PriceSmart) was spun-off from Price/Costco

- **“In 1993 Costco bought Price Club. But what appeared to be a harmonic convergence of protege and mentor instead became a troubled marriage. Meshing the two at the top was uneasy and ultimately unhappy – a failed experiment in sharing leadership between Sol Price's biological son, Robert, and his surrogate son, Sinegal. After just eight months Costco spun off a separate company called Price Enterprises, led by Robert Price. The company evolved into PriceSmart, which operates warehouse clubs overseas. Many of the Price Club managers stayed with Sinegal, embedding Sol Price's principles even more firmly in the Costco culture.”** *Fortune, November 2003*

AVERAGE SALES PER UNIT PER YEAR

The merger strengthened Costco, with the new company combining Costco's new concepts and Price's high unit volumes, continuing to outperform Sam's Club in unit volume

Average sales per unit per year of five largest wholesale club operators since origin of concept
 \$, millions, FY1976-FY2003



KEY METRICS

Costco is beating Sam's Club by getting more customers to have larger baskets more frequently

Key transaction metrics for household members: Costco vs. Sam's Club
 \$, actual, 2003

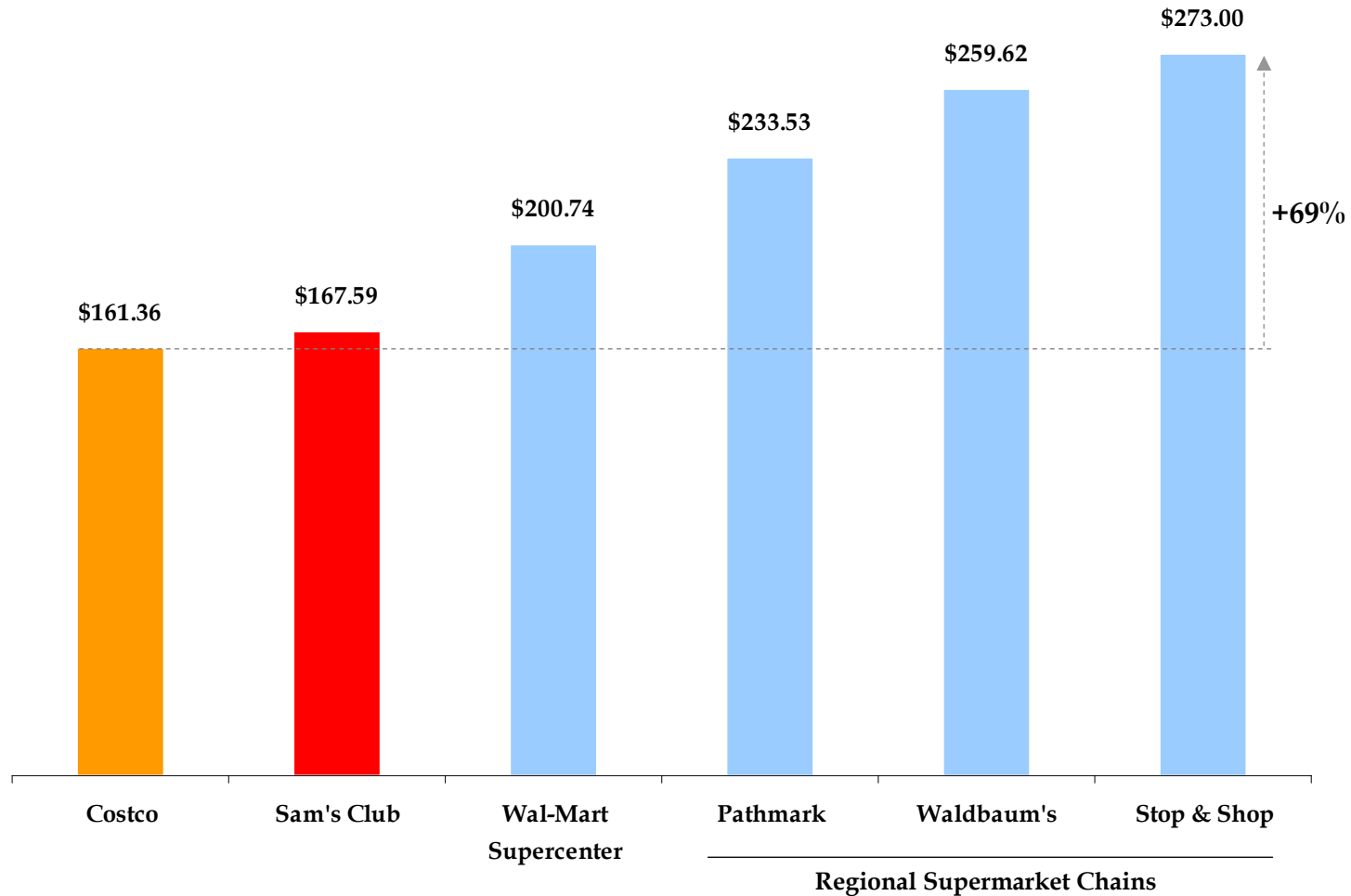
Does not include business customers



PRICE OF A 50 ITEM BASKET

Costco continues to deliver on lower prices than its competitors

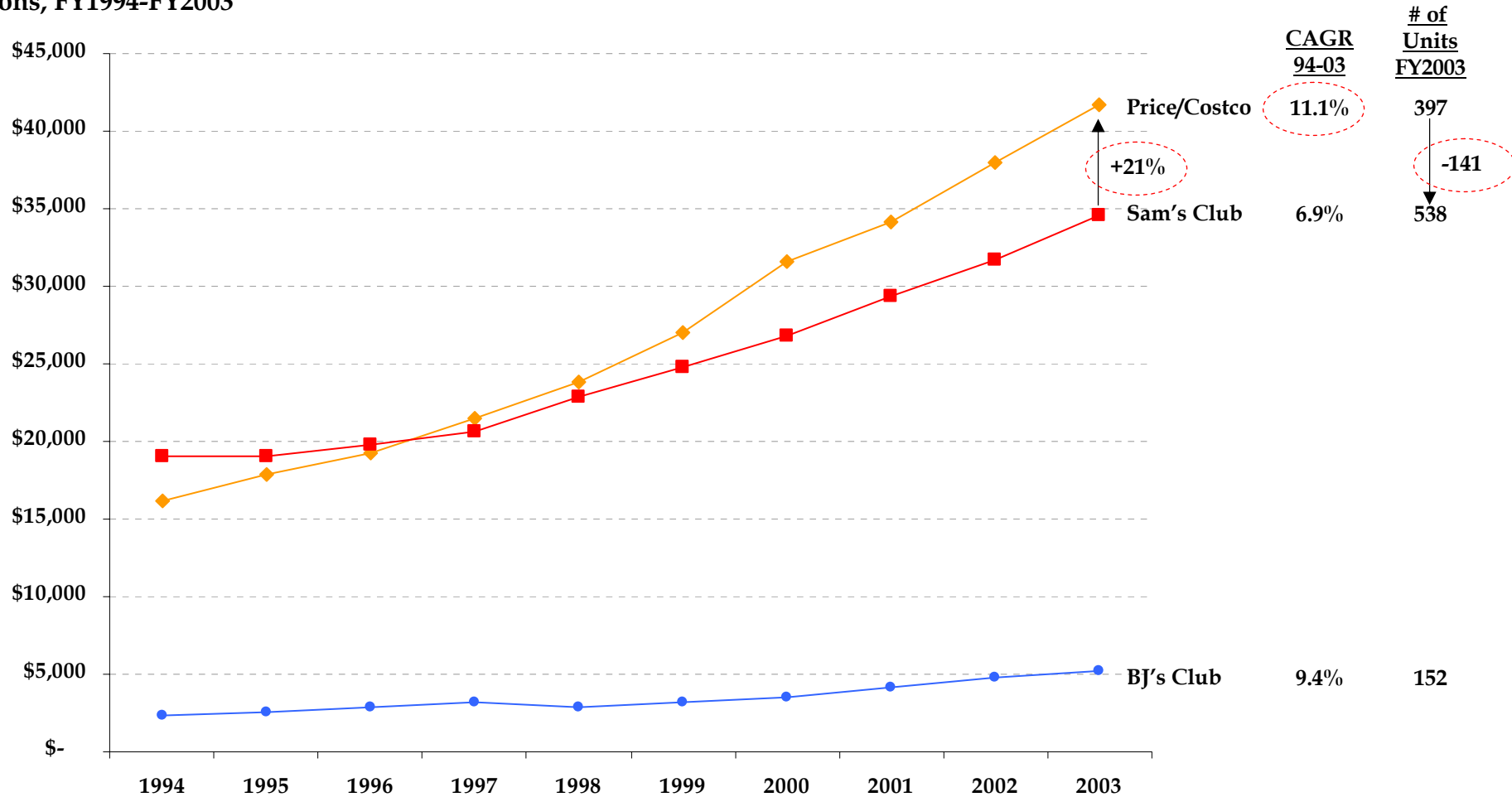
Value of randomly selected 50 item basket by company in Northeastern US
 \$, actual, 2002



GROUP SALES GROWTH

As a result, since the merger Costco has grown at 11% per year and today has total sales 21% greater than Sam's Club while having 141 fewer units

Total sales by group
\$, millions, FY1994-FY2003



BEATING WAL-MART

Costco is beating Sam's Club on a number of variables

Comparison of Costco and Sam's Club on select metrics various, FY2003

	Costco	Sam's Club (Wal-Mart)
Year founded	1983 (Costco) 1976 (Price Club)	1983
Presidents since founding	1	7
Membership cardholders	42 million	46 million
Annual membership fee	\$45	\$30-35
Average sales per US club	\$112 million	\$64 million
Number of clubs	318 US 79 International	538 US 80 International
Total sales	\$42.5B	\$34.5B
Average sales per square foot	\$797	\$497
Private label as a percent of sales	15%	10%

PITY POOR WAL-MART

As amazing as it sounds, Wal-Mart is the battling underdog of the wholesale club industry

- "Regardless of what Wall Street says, Sam Walton can't walk on water. As a matter of fact, neither can I." *Sol Price, Founder, Price Club, March 1989*
- "Pity poor Wal-Mart (a sentence I never thought I'd write). In this one niche, it's run up against a company that shows you can't discount some old business verities: The nimble first mover can outrun the powerful colossus; the innovator can stay a jump ahead of the imitator; the quality of leadership can trump the quantity of resources." *Fortune, November 2003*
- "Everybody out there is concerned about saturation. And I think that's partly because when our main competitor, Sam's, announced some management changes a few months ago, as a company they said that part of the reason that they were going to change what they do is that they see saturation in the business. We personally think that some of what they perceive as saturation has been competition from us and we still see lots of opportunities out there." *Richard Galanti, CFO, Costco, May 2003*
- "The potential for failure is tremendous, but then so is the potential for success." *Ron Loveless, VP, Sam's Clubs, Nov 1983*

SECTION 3: A WORLD-CLASS RETAILER

This section explains in detail the elements of Costco business model that allow it to be a world-class retailer and beat Wal-Mart



“The basics of our concept may be easy to understand, but that doesn't mean it is easy to implement. Imitators of our concept who maintain the discipline are likely to succeed, but only if they resist the temptation of starting to advertise, taking credit cards, offering free delivery, and doing other things that add costs.”

Sol Price, founder, Price Club, November 1990

THEORY

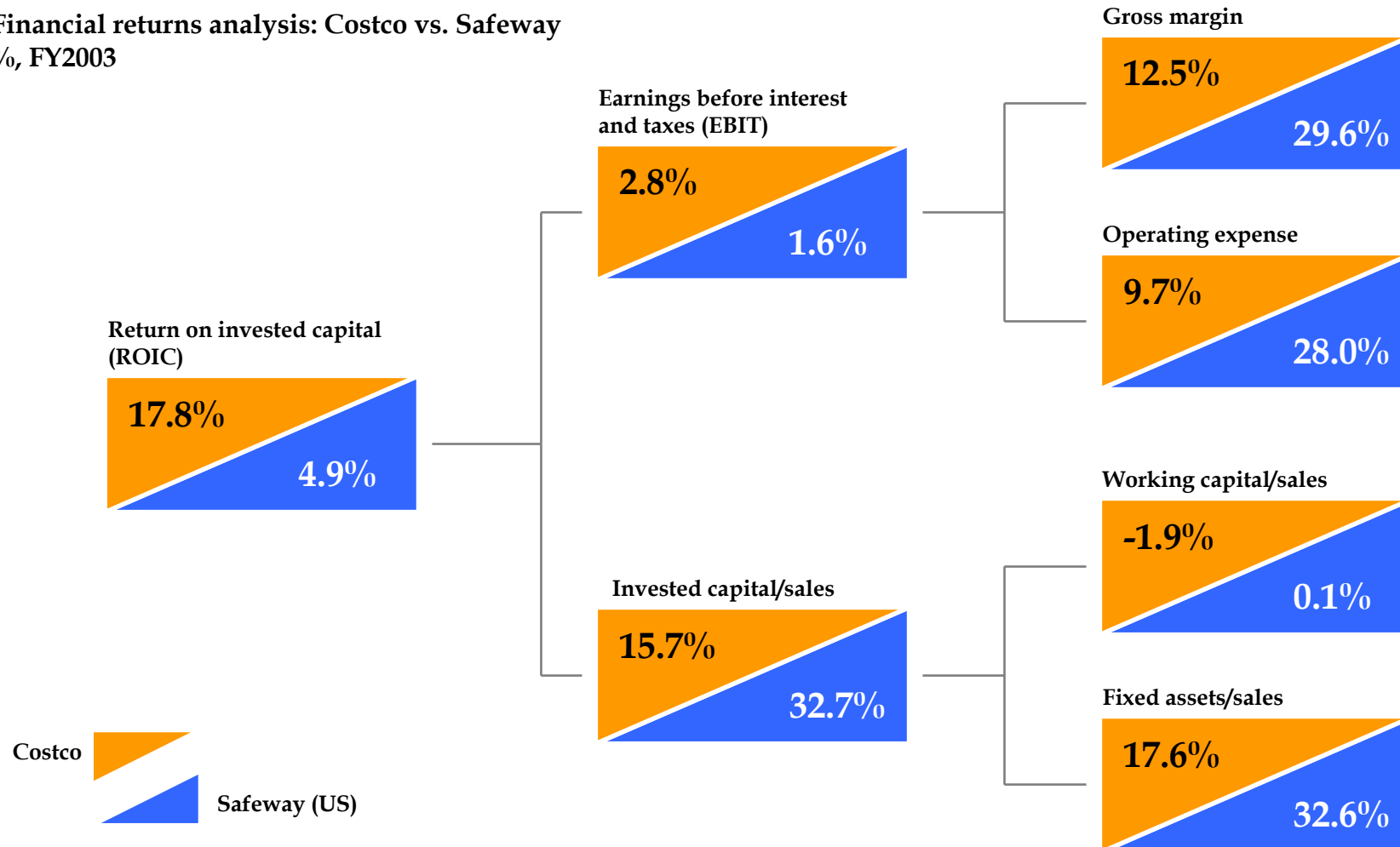
Wholesale clubs are simple in theory but difficult in practice

- **“It is not an easy business. A clear understanding of the concept and enormous management discipline in adhering to it are essential.”** *Joseph Ellis, Analyst, Goldman Sachs, March 1985*
- **“A store that tries to be all things to all people will end up being nothing to anyone. A retailer reflecting honesty, credibility and a definite direction that can be understood by its customers and vendors will have a good chance to make it.”** *Sol Price, founder, Price Club, March 1989*
- **“Perhaps because we were the first, we have a more thorough understanding of the concept. Those who copy may not have the basic rationale so clearly in mind.”** *Robert Price, President, Price Club, April 1989*
- **“Keep it simple. Unfortunately that objective has become more difficult as a business grows as fast as we have.”** *Sol Price, founder, Price Club, February 1989*

FINANCIAL RETURNS: COSTCO VS. SAFEWAY

Costco achieves higher returns on lower margins than (for example) Safeway

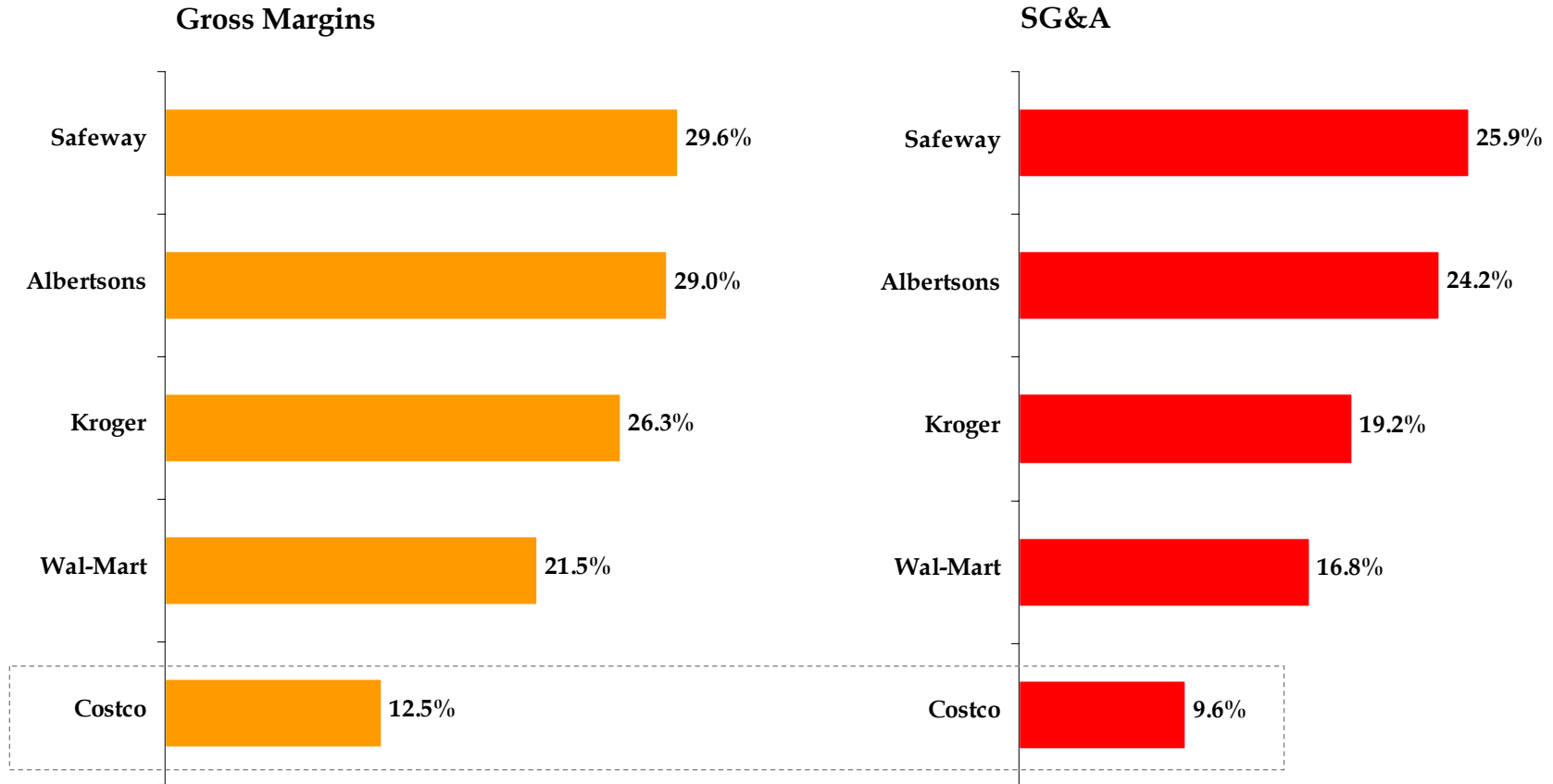
Financial returns analysis: Costco vs. Safeway
%, FY2003



LOW MARGINS

Costco takes much lower gross margins than its major competitors and does this by religiously controlling selling, general and administrative expenses (SG&A)

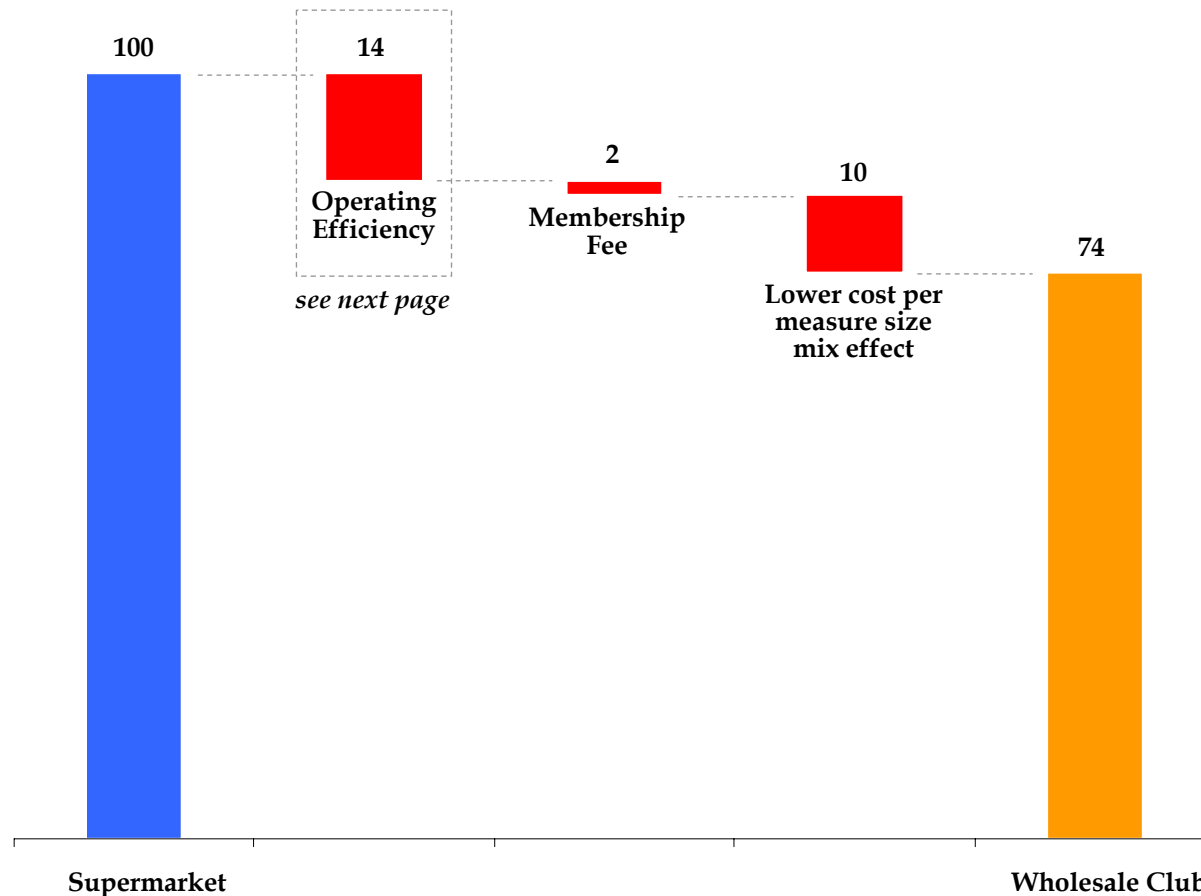
Gross margin and SG&A as a percent of sales
%, FY2003



LOWER COSTS DRIVE LOWER MARGINS

Wholesale Club stores achieve lower margins than supermarkets through three factors: operating efficiency, membership fees and selling a different size mix

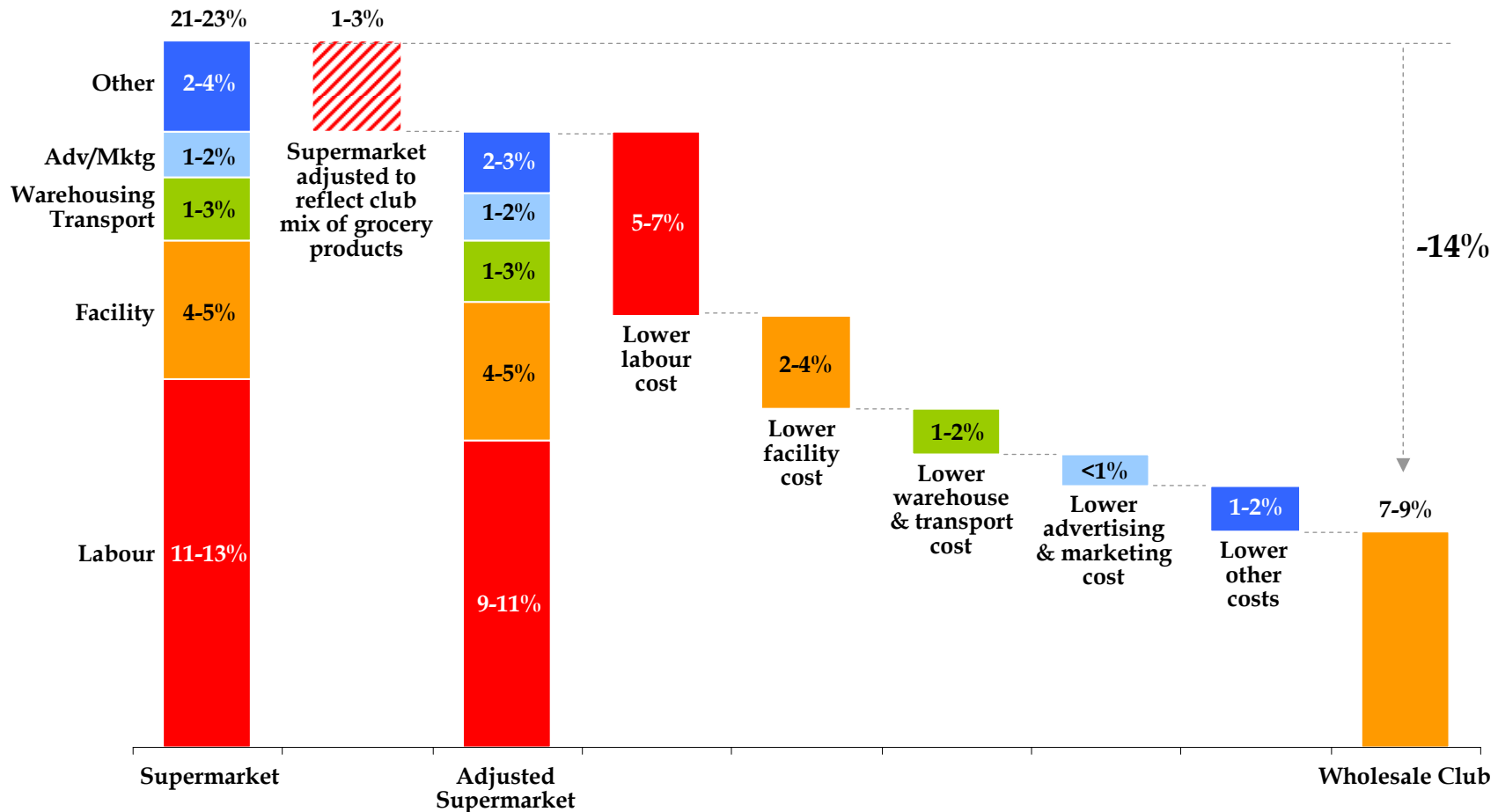
Drivers of lower basket price in membership club operations
 Index, 100=supermarket average



DRIVERS OF LOWER BASKET PRICE

Wholesale Clubs achieve lower operating efficiency through having an efficient but bare-bones cost structure

Drivers of lower basket price in membership club operations
Index, 100=supermarket average



COST CONTROL

Religious cost control is at the heart of the wholesale club concept

- **"I never charge the company for any of my traveling expenses... That's all part of our culture." Sol Price, founder, Price Club, February 1989**
- **"What is your greatest concern for Costco?" "Our concern is always that we continue in all our warehouse units to instill a discipline of pricing in our type of operation - a discipline of cost containment at every level of our company. That's always our main concern, that we don't lose that thrust. That's what has made us a viable business force on the retail scene in North America. We have a fanatical attitude about cost containment." Jim Sinegal, CEO, Costco, February 1999**
- **"Price Club management is frugal right down to their socks. The company's annual report is a slim white volume with no photographs. It is mailed out with the fourth quarter report and the proxy statement, to save money." New York Times, December 1988**
- **"The temptations are everywhere. It wouldn't be difficult to increase the gross margin by a point or two. Prices would still be well below almost any retailer. But it would defeat the purpose. The same is true for opening membership to the public, or increasing sku's to offer a broader selection, or using price-oriented advertising, or allowing the use of credit cards. Each element of the strategy--facilities, operating efficiency, disciplined assortment, systems and, most of all, pricing--must be in place, or the concept can easily fail. There is absolutely no margin for error. The warehouse clubs are operating on an average 9% gross margin, compared to around 30% for discount chains. That doesn't give them a lot of room to cover any changes in their cost structure." Joe Ellis, analyst, Goldman Sachs, November 1983**
- **"As close to the bone as Costco operates its business, the company constantly finds ways to enhance efficiency and to increase productivity; if the company has thrived by picking up stray nickels and dimes of reduced operating costs here and there, plenty of loose change remains to be pocketed." Ed Weller, analyst, ThinkEquity, December 2003**

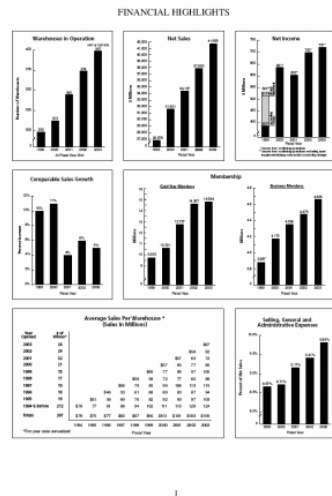
LATEST ANNUAL REPORT - FIRST PAGES

Unlike Wal-Mart, Costco's annual report is printed in black and white on cheap paper

First two pages of latest annual report: Costco vs. Wal-Mart

Costco

THE COMPANY	
<p>Costco Wholesale Corporation ("Costco" or the "Company") began operations in 1983 in Seattle, Washington. In October 1993, Costco merged with The Price Company, which had pioneered the membership warehouse concept in 1976, to form Price/Costco, Inc., a Delaware corporation. In January 1997, after the spin-off of most of its non-warehouse assets to Price Enterprises, Inc., the Company changed its name to Costco Companies, Inc. On August 30, 1999, the Company reincorporated from Delaware to Washington and changed its name to Costco Wholesale Corporation, which trades on the NASDAQ under the symbol "COST".</p> <p>Costco operates a chain of membership warehouses that sell high quality, nationally branded and selected private label merchandise at low prices to business purchasing for commercial use, personal use, or resale, and also to individuals who are members of selected employee groups. The Company's business is based upon achieving high sales volumes and rapid inventory turnover by offering a limited assortment of merchandise at a wide variety of product categories at very competitive prices. As of December 2009, the Company operated a chain of 430 warehouses in its company and former Price (118 locations), nine Canadian province (62 locations), the United Kingdom (13 locations), Korea (five locations), Taiwan (three locations), through a 50%-owned subsidiary and Japan (five locations), as well as 23 warehouses in Mexico through a 50%-owned joint venture.</p>	
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Wal-Mart

Senior Officers

- Michael S. Duke, Chairman and CEO
- Thomas M. Coakley, President and Chief Operating Officer
- Gregory A. Breen, Executive Vice President, Logistics and Supply Chain
- David D. Olson, Executive Vice President and Chief Financial Officer
- Joseph J. Placencia, Executive Vice President, Retail Merchandise
- Charles G. Schultz, Executive Vice President, General Merchandise
- Gregory S. Bynum, Executive Vice President, Merchandising
- Christine M. Simmons, Executive Vice President, Customer Service
- William C. Miller, Executive Vice President, Information Technology
- Thomas E. Jones, Executive Vice President, Human Resources
- Joseph J. Placencia, Executive Vice President, Merchandising

Financial Highlights

2009	2008	2007
\$16.58	\$16.49	\$16.49
\$16.58	\$16.49	\$16.49
\$16.58	\$16.49	\$16.49

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REINVEST IN PRICING

Savings are reinvested in lower prices rather than better margins

- **"I remember him threatening to fire me because I was too successful on a promotion. I bought a big consumer electronics closeout and sold out in one week at a 50 percent gross when we were probably running electronics at a 25 percent margin. He just raised holy hell that I went up on margins so much; the benefit should have been passed on to the consumer."** *unnamed Price associate, quoted in Discount Store News, August 1988*
- **"I never allowed anybody at Fed-Mart to use the word "discount." The whole philosophy was: How do we sell stuff at the lowest markup rather than the deepest discount? I never allowed them to use superlatives or comparative pricing or to have sales. All those things were gimmicks. We tried to look at everything from the standpoint of, is it really being honest with the customer? If you recognize you're really a fiduciary for the customer, you shouldn't make too much money."** *Sol Price, founder, Price Club, November, 2003*
- **"This business is a matter of picking a return instead of going after every dollar we can squeeze out of the market. We have to avoid the temptation of increasing our return. If we can end up with a net of 2%, and our economies are such that we can increase that to 2 1/2% or 3%, I think we should consider cutting prices instead."** *Walter Teninga, President, The Warehouse Club, November 1983*

THE EVERYDAY PRICE LEADER

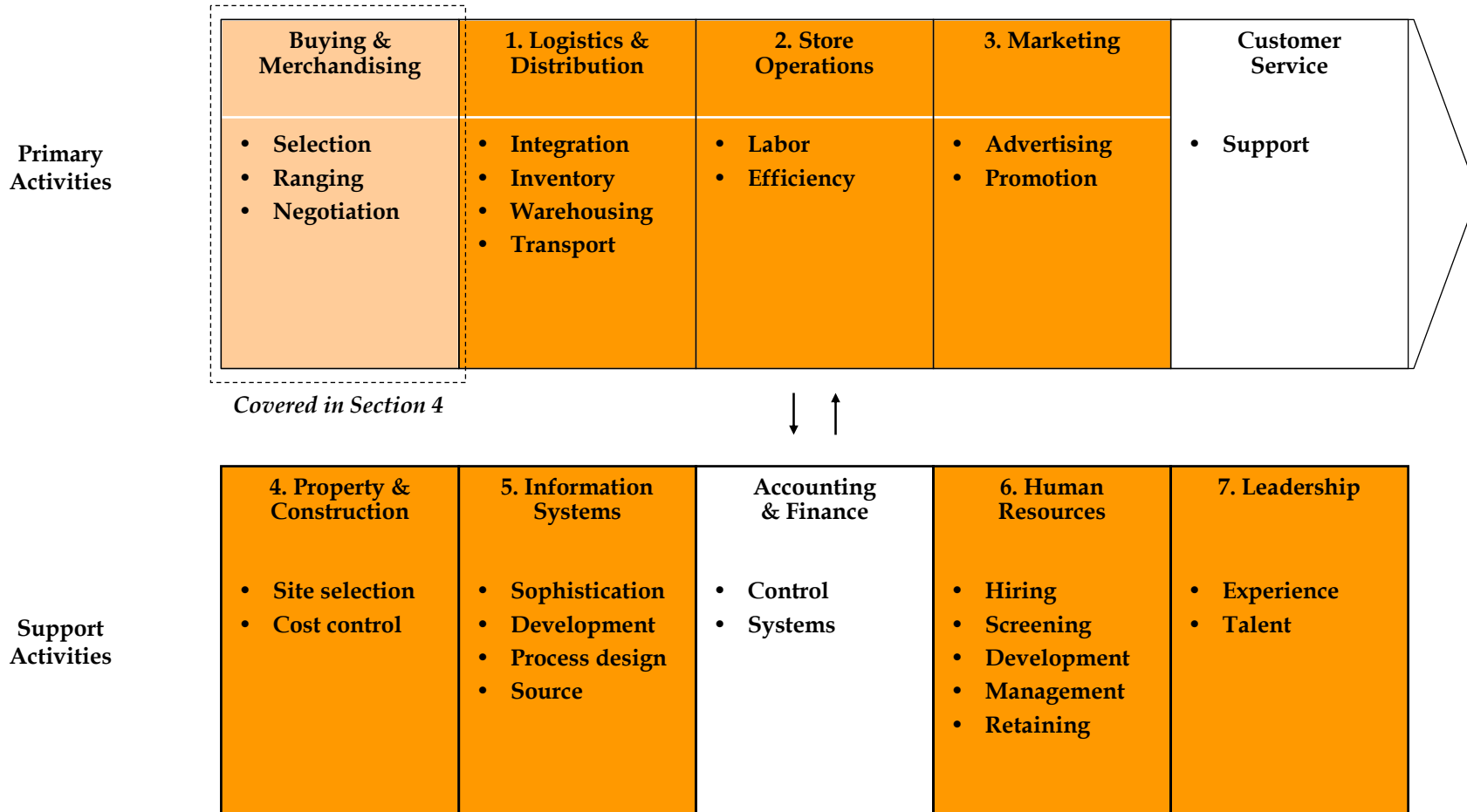
Costco is the everyday price leader

- **"My attitude toward pricing policy is 'give before you get.' The lower the prices you offer, the more business you get. It becomes a chicken and egg type of thing: which comes first, low prices or high volume? Gandhi was asked about belief. He said, 'If you believe, you are ready to renounce everything - even life - for your belief.' Then he was asked, 'Does the belief precede the renunciation?' He answered, 'Oh no, the renunciation precedes the belief.' My attitude has always been give before you get, and by giving you end up getting."** *Sol Price, founder, Price Club, November 1990*
- **"We are considered the leaders in pricing; we're considered the most sophisticated in our business; and we're high-end. That's something we've worked for 20 years. You don't just develop that overnight."** *Jim Sinegal, CEO, Costco, August 2002*
- **"When a competitor constantly beats Price Club's price on certain products, rather than drop those items, we should first evaluate how he's accomplishing that. His sales personnel may be switching customers to higher priced items; he may be giving some things away while making up the loss with higher margins elsewhere. Our best answer to such practices has been to maintain our volume, be crisp, maintain our operating costs and live on the margins we've set. If we do that well, it will be pretty tough for someone, with additional costs of advertising and slower inventory turns, to match us."** *Sol Price, founder, Price Club, March 1989*
- **"The warehouse club format isn't fertile ground for the kind of price wars that have characterized other retailers... clubs don't use print advertising, they constantly change their product mix, and they decline to use loss leaders."** *Stephen Mandel, Analyst, Goldman Sachs, August 1989*
- **"The term 'price war' is a little overdramatic... I'd say it's a sharpening of prices."** *Jim Sinegal, CEO, Costco, August 2003*

COSTCO'S VALUE CHAIN

To understand the secrets to Costco's success, we need to look at its value chain

Costco's value-chain and where it excels



1. LOGISTICS & DISTRIBUTION

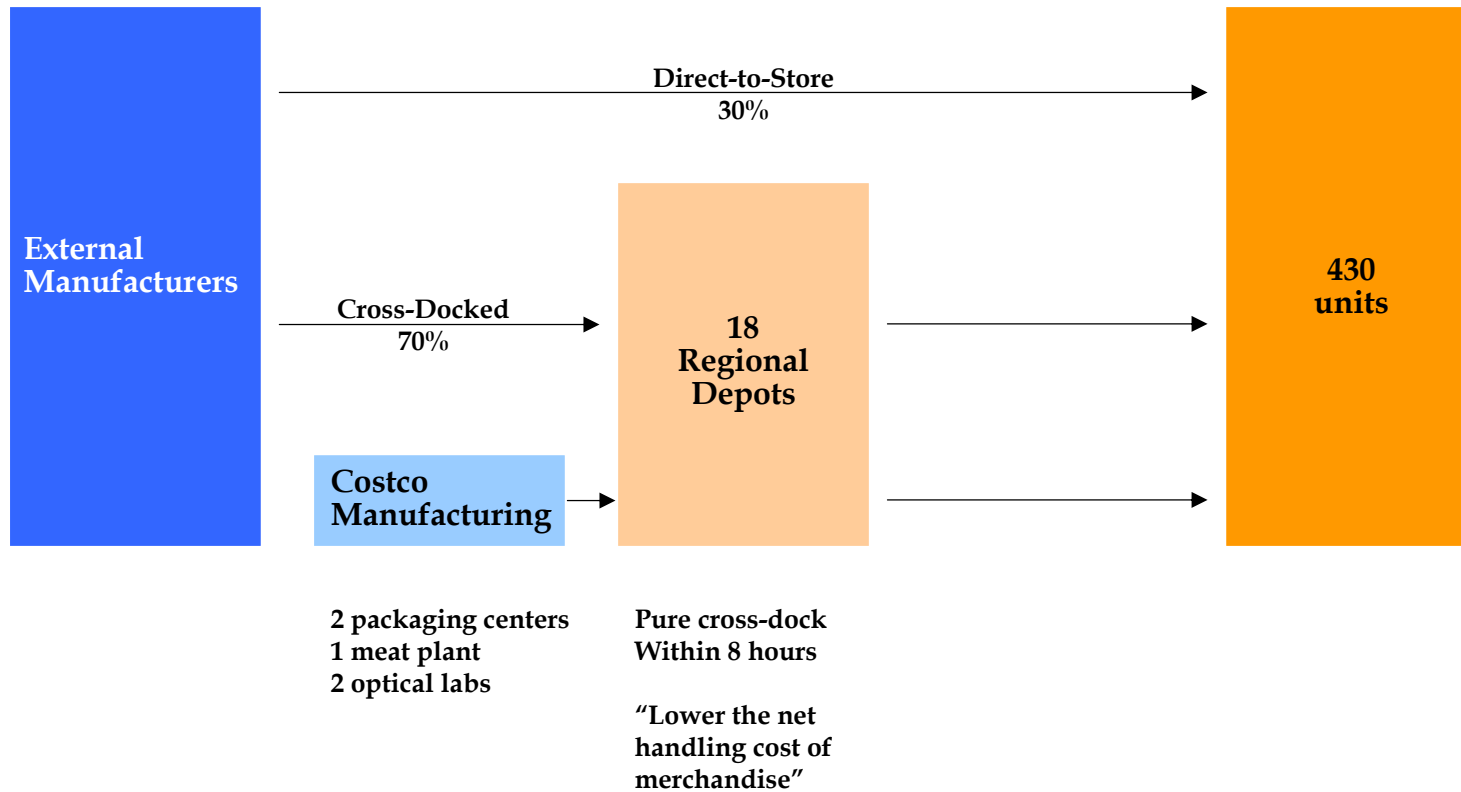
Costco operates a streamlined and highly efficient supply chain

- **“With a low operating cost structure built upon logistics that minimize material handling and promote efficient packaging that is designed for large average transactions, the company has developed a sustainable and not easily replicable competitive advantage.”** *Jonathan Ziegler, analyst, Deutsche Bank, May 2000*
- **“The warehouse clubs are hugely-efficient channels of distribution which just strip cost out of every link in the supply chain.”** *Paul Deacon, analyst, Goldman Sachs, March 1992*
- **“Costco buys nearly all of its merchandise directly from manufacturers for shipment either directly to Costco’s selling warehouses or to a consolidation point (“depot”) where various shipments are combined so as to minimize freight and handling costs. As a result, Costco eliminates many of the costs associated with multiple step distribution channels, which include purchasing from distributors as opposed to manufacturers, use of central receiving, storing and distributing warehouses, and storage of merchandise in locations off the sales floor. By providing this more cost-effective means of distributing goods, Costco meets the needs of business customers who otherwise would pay a premium for small purchases and for the distribution services of traditional wholesalers, and who cannot otherwise obtain the full range of their product requirements from any single source.”** *Costco 10K, 2002*

1. LOGISTICS & DISTRIBUTION

Costco operates cross-docking depots that receive goods from vendors, that are then consolidated into full truckloads and shipped to stores within eight hours.

Costco merchandise distribution flow model



2. STORE OPERATIONS - DÉCOR

Costco operates massive 100,000 square foot outlets with the minimum of fittings and fixtures

- **"We keep the insides of them pretty plain."** *Jim Sinegal, CEO, Costco, July 1997*
- **"The mammoth 100,000-square-foot warehouse four miles outside downtown Albuquerque has all the charm of an airplane hangar."** *Money, October 1985*
- **"The stores are drafty when the weather is cold and stuffy when it is hot. Customers have to find dollies and grappling hooks and then wrestle refrigerators, desks, and other heavy items to the checkout line themselves."** *Business Week, March 1985*
- **"Their ceilings are lost in the heights; their floors are bare concrete. Winds from wide doors whisk through open spaces stuffed with utilitarian metal shelving and boxes of goods. Though warehouse wholesale outlets have little eye appeal, customers are flocking to them in the latest version of cut-rate shopping."** *Seattle Times, February 1985*
- **"Inside, there are concrete floors and high ceilings--important elements to accommodate the four-level steel racks that contain the bulk of merchandise. The aisles are wide to allow the forklifts access to the shelves, which are constantly restocked with merchandise all day... Customers use large, basket-style shopping carts to hold selected products displayed in packing carts or pallets or steel racks. Customary retail store amenities such as heating, air-conditioning, paper bags and restrooms are not available."** *Chain Store Age Executive, May 1983*
- **"The average warehouse club carries a low- or no-frills decor, and shoppers often have to steer their carts around forklift trucks lifting goods up to ceiling-high shelves."** *Chicago Sun-Times November 1989*
- **"Membership warehouses are gargantuan, cavernous warehouses, averaging 100,000sq ft each, with cartons of products ranging from household appliances to bags of sugar stacked high on concrete floors. Devoid of fixtures and sales help, shoppers must fend for themselves, climbing atop stacked cartons to transfer what they need onto oversized shopping carts. It is slightly more pleasurable than shopping in Moscow in that goods are in plentiful supply, but the checkout lines can be just as long at weekends. It is best to shop in groups and to bring a small lorry to carry purchases home."** *Supermarketing (UK), March 1992*

2. STORE OPERATIONS – LOW OVERHEADS

Costco outlets are no-frills, low overhead operations

- **“Costco is able to offer lower prices and better values by eliminating virtually all the frills and costs historically associated with conventional wholesalers and retailers, including salespeople, fancy buildings, delivery, billing and accounts receivable. We run a tight operation with extremely low overhead, which enables us to pass on dramatic savings to our members.”** *Jim Sinegal, CEO, Costco, June 2000*
- **“Overhead is kept low as a result of minimum staffing, low rent, lack of deliveries, incidental use of credit cards, and minimal advertising. This translates into considerable savings for members.”** *The Appraisal Journal, April 1990*
- **“Labor costs are kept to a minimum, although wages are high. The stores keep limited operating hours, designed to cater to business customers. Products arrive on pallets, and the are moved to shelves on forklifts during the day. There is only one bank of checkouts, where orders are keyed into electronic registers with a simple numeric price lookup code that manufacturers put on specially prepared multipacks or single, institutional size packages. All sales are by cash; no credit cards are accepted.”** *Supermarket Business, November 1990*
- **“Warehouse clubs also keep shorter hours than conventional retailers, about 60 to 65 hours a week, compared with 75 to 80 hours a week at most non-food retailers and 168 hours a week for 24 hours-a-day supermarkets. Labour costs are about 5% of sales at new stores and 3.5% at older, well-established stores.”** *Supermarketing, March 1992*
- **“Minimum inventories -- all stocked on the selling floor -- and 100% self-service also helps cut operating expenses and, because items are sold in such large lots, losses from theft are lower.”** *Supermarketing, March 1992*
- **“Further, the club itself, with its warehouse shelving, high ceilings, and concrete floors, is a no frills, low-maintenance facility that is designed to facilitate the efficient handling of large quantities of merchandise and for self-service by the customer. Merchandise is often displayed on pallets or in cut cartons, and excess goods usually are stored on the sales floor rather than in a distribution center or non-selling warehouse.”** *Sally Wallick, analyst, Legg Mason, Spring 2000*

2. STORE OPERATIONS – FOCUS

Costco has its club managers focus on doing the basics right

Key responsibilities of a Costco club manager

- 1. Drive sales**
- 2. Drive member services**
 - a. Merchandising**
 - b. Front-end**
 - c. Quality**
 - d. Cleanliness**
- 3. Safety, Safety, Safety**
- 4. Leverage expenses**
- 5. Grow membership – Business, Gold Star and Executive**
- 6. Grow people**

3. MARKETING & ADVERTISING

Costco spends a minimal amount on advertising, mostly direct mail to existing or potential customers

- **“We've never had to use much advertising. Instead, we communicate with our customers in newsletters, and these newsletters are not self-serving advertising pieces. They include lots of stories about our members - who they are and what they're doing - so the newsletters are interesting to read. We use the newsletter as a way to take the consumer's side on issues. and to stimulate discussion of things that relate to our business like solid waste disposal. And the newsletters include informational advertisements and other information our members can use as they shop our stores.”** *Sol Price, founder, Price Club, November 1990*
- **“When we use advertising, it is low key and information-oriented. We strive to make our advertising absolutely clear. We have never used comparatives - for example, saying regular retail price is so much and the Price Club price so much. We never used superlatives like "best," or "lowest," or "cheapest" in our advertising. We make sure the merchandise we offer is top quality. We do not offer unpopular lines of goods, seconds, or out-of-season stock. Our refund policy is that when customers bring something back, they get their money right up at the front register - no red tape. Every part of our operation is focused on being cleaner than clean. We learned that you can do very well in the retail business without cheating, lying, being cute or spending a lot of money on advertising.”** *Sol Price, founder, Price Club, November 1990*

3. MARKETING & ADVERTISING

More extensive marketing campaigns often accompany new club openings, including personal calls on small businesses in the area that are potential business members

- One year free membership is offered to select target customers
- **“There's a need for institutional advertising prior to opening and during the early days of operation. We have to tell potential shoppers what this business is all about. At the same time, we have to avoid price-oriented advertising. We don't want to end up where shoppers are just coming in to cherry-pick the ads. There's a need for group members to be marketed to through their parent organization, whether it's a tuck-in with their pay envelopes or credit union statement. Not only is this a better way to access them compared to newspaper advertising; the endorsement from the parent organization is very valuable. However, the most important thing is getting word of mouth from member to member.”** *Walter Teninga, President, The Warehouse Club, November 1983*
- **“The Company does not generally use media advertising except newspaper announcements of new Price Club openings. When a new warehouse is opened, businesses in the area are canvassed by marketing teams. This is followed by a direct mailing to potential business members in the area. Potential Gold Star members are approached through credit unions, employee associations or other entities representing the particular individuals who are eligible for Gold Star membership.”** *Price Club 10K, 1989*

4. PROPERTY & CONSTRUCTION – SITE SELECTION

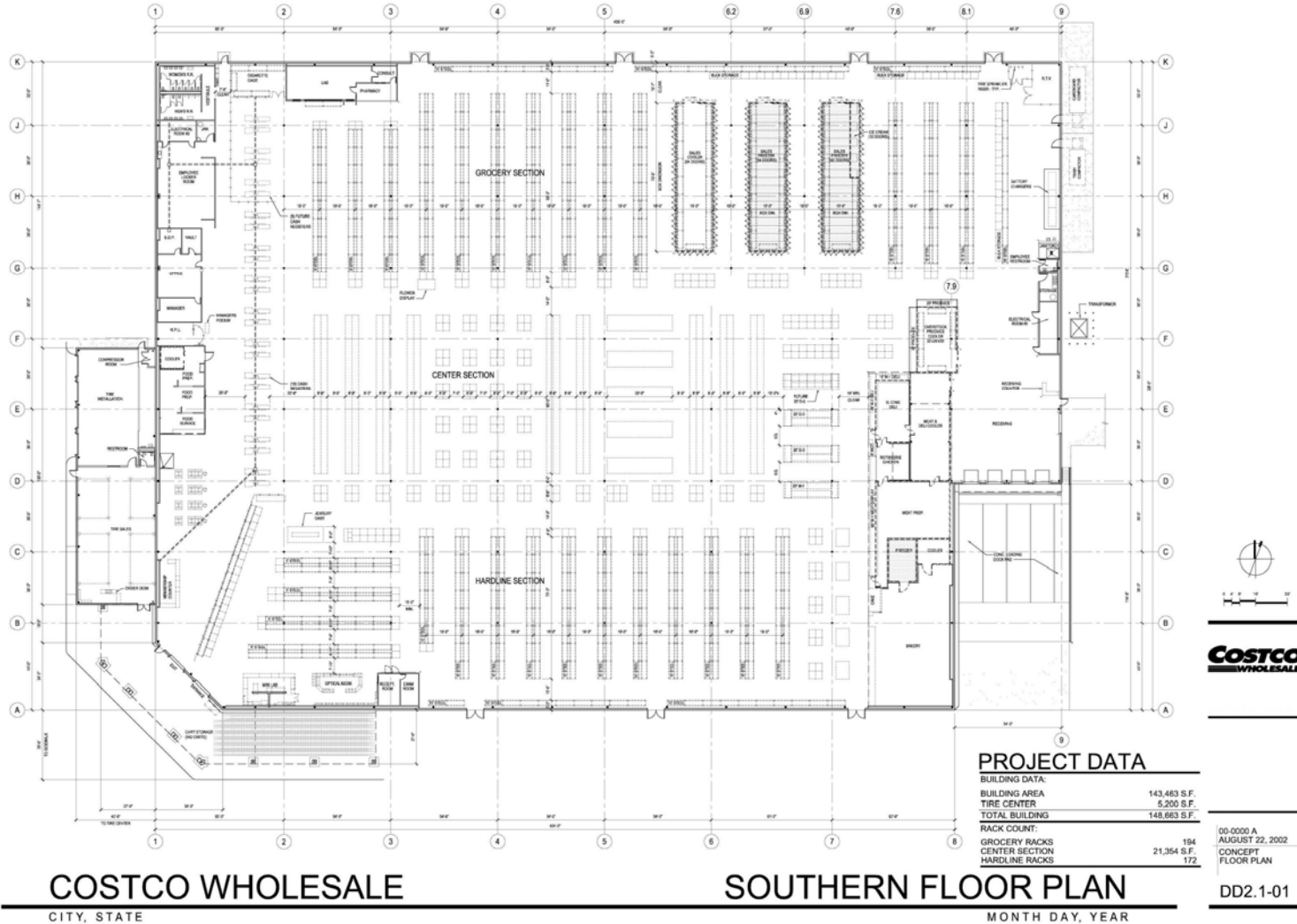
Costco stores are never located in malls or prime real estate

- **“First, dispense with some of the niceties of conventional retailing. Location doesn't matter as long as you're on a highway somewhere near a reasonably large city. Architecture isn't crucial either; any old airplane hangar or derelict factory will suffice (100,000 square feet is about right). The best decor is none at all: rough concrete floors, steel shelves to the ceiling, perhaps a few simple pallets. Customer perks are anathema--no credit, no sales staff, no after-sale services. Now buy vast amounts of merchandise, mark it up a bare 10% or so, and limit your clientele to members only. What you've got is a warehouse club, the hottest new wrinkle in a discounting.”** *Fortune, December 1984*
- **“While the original idea of locating warehouses in out-of-the-way locations where real estate was cheap has been modified in some locations, the company’s warehouse for the most part need not be located on prime commercial real estate sites. The company’s warehouses are often located on the outskirts of major cities. They are not elaborate facilities, but rather simple, large boxes designed for economy and efficiency in the movement of goods. It is the cost savings that keeps attracting the company’s customers. The formula has worked so well that now regional malls frequently recruit the company in efforts to draw traffic.”** *Jonathan Ziegler, analyst, Deutsche Bank, May 2000*
- **“The stores are placed in industrial sites, where real estate is cheaper.”** *New York Times, December 1990*
- **“They're usually located in out-of-the-way locations to save on land costs.”** *Chain Store Age Executive, May 1983*
- **“In California, warehouses seem natural: Almost everyone drives and has plenty of space at home. Warehouses make less sense where land is expensive and hard to come by, where zoning regulations are fierce, where the traffic is heavy and home storage space is limited. New York City comes to mind.”** *New York Times, December 1988*

4. PROPERTY & CONSTRUCTION - DESIGN

Costco's simple, modular, low cost, "cookie-cutter" stores can be built in 100 days (if required)

Store plan



4. PROPERTY & CONSTRUCTION

The process of building a cookie-cutter club is simple and streamlined

- New store openings require:
 - Land
 - Building
 - Pre-opening costs \$1 million (labor, training, don't promote heavily)
 - Startup working capital of net 4-5 days

- "Senior management just went through a two-day review of all the sites that our real estate department is working on. Just in the US it's a list that is in excess of 150 active projects." *Richard Galanti, CFO, Costco, May 2003*

- Costco has reduced construction costs by adding modular components that are easily conformable to local requirements

New Build (time to build 100 days+)

Building costs	\$6.4m
Site costs	\$0.7m
Off-site costs	\$0.5m
TOTAL	\$7.6m
Remodel	
Average	\$800,000
Gas Station	\$685,000



4. PROPERTY & CONSTRUCTION - OWNERSHIP

Costco prefers to own its own sites where possible

- "Where possible we've bought excess land and gradually built it into rental income properties." *Sol Price, Founder, Price Club, March 1989*
- Costco owns 80% of its real estate (land and building) which is unencumbered; it leases the remainder. This ensures locked-in occupancy costs
- The construction of a Costco creates a destination - by developing and owning what was originally a low value site, Costco collects rent from its own customer draw
- "I'm not fazed by having competitors in the development with us. Retailers who say no to this are kind of stupid, because it means that competitor is going to locate three blocks away and you are not going to get the traffic." *Robert Price, President, Price Club, December 1988*
- "By setting up shop in out-of-the-way locations, Price pays rock-bottom prices for its real estate. By leasing space to other retailers, Price generates extra revenue... and increases the flow of shoppers." *New York Times, December 1988*
- "Price Club preferred to hold its own real estate and at the end of 1989 it owned all but two of its of its warehouse club sites. The company devised a shrewd real estate strategy to facilitate expansion. It would acquire excess acreage whenever possible in low-cost, semi-industrial areas that had no proven traffic draw. It then developed these company-owned sites into shopping centers, or 'power-centers,' with other high-volume, low markup specialty retailers as co-tenants." *Wal-Mart: A History of a Phenomenon, 1994*

5. INFORMATION SYSTEMS – FOCUS

Costco's IT department has 460 employees focused on developing software for internal use

- Responsibilities:**
- Supply chain (ordering and replenishment)
 - depots and distribution
 - network (local and wide area, data center, disaster recovery and security)
 - hardware and software
 - ancillary businesses and e-commerce
- Guiding principles:**
- (1) maintain very low information system costs
 - keep it simple
 - 80% functionality, 20% of the time
 - adopt after hype unless there's a business catalyst (i.e. pharmacy workflow)
 - (2) provide high quality service
 - accurate, reliable and available data and systems
 - done right
 - (3) understand the business and apply knowledge in creating systems
 - work in small area/small steering committee to hone efforts
 - encourage simple solutions
 - senior business sponsorship and partner development
 - (4) focus on return on investment
 - payback in less than two years
 - total cost of ownership (TCO) to be spread over five years
 - measure actual results
- Reliability** The company's systems run with "four-9s reliability" (i.e. 99.99% uptime)

5. INFORMATION SYSTEMS - CURRENT PROJECTS

Costco's IT department is working on the following projects

Projects for 2003:

1. Rapid receiving
 - entire truckloads are received by scanning a single barcode
 - previously scanned each pallet
2. Sales audit automation
 - saves eight hours per club per week
3. New membership system
 - can verify membership at the time of purchase
4. Roll-out of executive membership in Canada

Projects for 2004:

1. Opportunities at POS
 - continue to decrease checkout time
 - from 30 members per hour to 40 members per hour
 - checkout speed is 8% faster
 - test self-checkout and signature capture
 - evaluate scanning technology and RFID
2. Supply chain opportunities
 - internet EDI (currently piloting with top ten vendors)
 - vendor extranet
 - replenishment and buying process

5. INFORMATION SYSTEMS - SIMPLICITY

Simplicity is the hallmark of Costco's IT program

- **"There are some disadvantages to getting too much information. It just sits on people's desks." Robert Price, President, Price Club, December 1988**
- **"How, if at all, can you use micro marketing, to the extent that you do any marketing, given the data base of members that you have?" "Well, micro marketing is not our shtick. I mean, the whole thing about our business is simplicity and trying to do something like send out a letter to somebody or an e mail to someone who purchased fertilizer or roses last year, is not what we do. So it's not going to be in the scheme of things for us." Jim Sinegal, CEO, Costco, May 2003**

6. HUMAN RESOURCES – MEASURES

Costco is a good employer, with generous pay and benefits and therefore has low employee turnover

Key Costco employee human resource measures
2003

		Costco	Wal-Mart
Number of employees		103,000	1.5 million
Percent of employees who are	Full-time	57%	70%
	Part-time	43%	30%
Typical cashier wage		\$10.50-17.50	\$7.65-11.45
Employees covered by company health insurance		82%	48%
Insurance enrollment waiting period	Full-time	3 mo	6 mo
	Part-time	6 mo	24 mo
Portion of health-care premium paid by company		92%	66.6%
Annual turnover rate (including summer hires)	Employees	23%	50%
	Managers	1.6%	n/a
Average Age	Employees	35	n/a
	Managers	43	n/a
Time with company	Employees	5 years	n/a
	Managers	15 years	n/a

6. HUMAN RESOURCES - HIGH WAGES

Low prices doesn't have to mean low wages

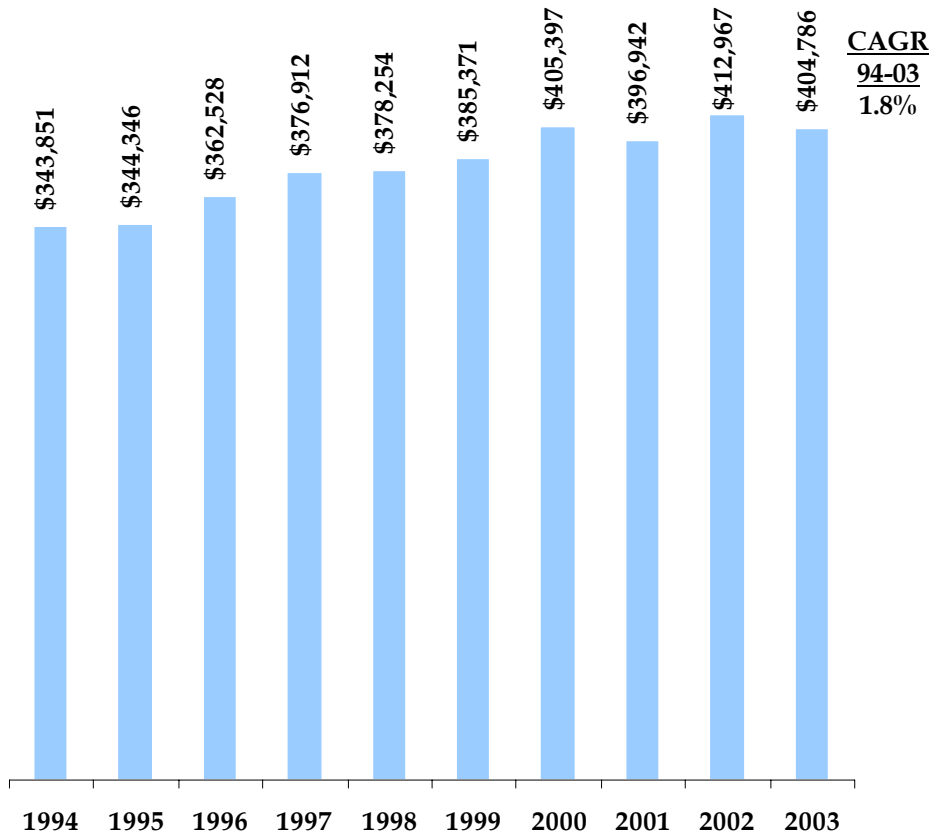
- **"We demand the best from our employees, and reward them for performance." *Sol Price, founder, Price Club, November 1990***
- **"From day one, we've run the company with the philosophy that if we pay better than average, provide a salary people can live on, have a positive environment and good benefits, we'll be able to hire better people, they'll stay longer and be more efficient." *Richard Galanti, CFO, Costco, March 2004***
- **"It is the Company's policy to pay close to the highest prevailing wages and benefits in the community... The Company has a defined contribution retirement plan for all employees... All qualified employees are covered by group health benefits, long-term disability, accidental death and dismemberment and life insurance at the Company's expense. Qualified employees' dependents also receive group health benefits at the Company's expense." *Price Club 10K, 1989***
- **"We are proud to have a very low rate of employee pilferage. One of the ways to achieve that is to pay people well, teach them so that they actually understand the business, be alert and set the right example. If employees get the right example from the leader - whether it's the warehouse manager or the chairman of the board - they are likely to follow." *Sol Price, founder, Price Club, November 1990***
- **"To increase productivity, the company has raised worker and manager salaries to the highest in the industry. Managers are in incentive schemes, while workers start at \$8 an hour -- \$1 more than other warehouse clubs pay - and work up to \$14 an hour after three or four years." *Supermarketing, March 1992***
- **"Costco's employees don't have much to complain about, either. They are given quarterly raises until they are some of the better-paid in retail. The 1,200 administrative employees at the Issaquah, Wash. headquarters are indexed in the company directory by first name, which is what shouts out from a Costco ID tag--Jim (Sinegal), Jeff (Brotman), Dan (Castillo), a first-year stockman. Parking at the headquarters lot is allocated by length of service. No employee of longer than three years' tenure can be let go without Sinegal or Chief Operating Officer Richard DiCerchio signing off (same with a vendor of longer than two years)." *Forbes, August 1997***

6. HUMAN RESOURCES - EMPLOYEE EFFICIENCY

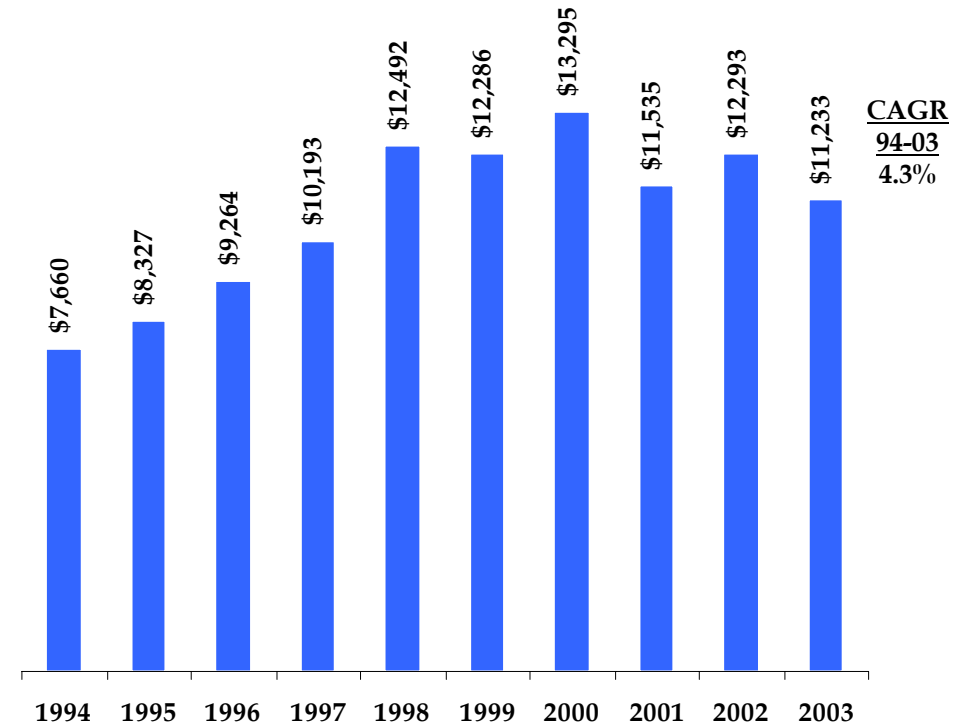
In 2003 Costco recognised a stunning \$404,786 in sales per employee and \$11,233 in operating profit per employee

Key Costco employee efficiency measures
\$, actual, FY 1994-FY2003

Sales per employee



Operating profit per employee



6. HUMAN RESOURCES – STRONG CULTURE

Costco has a strong company culture stretching back to Price Club

- **“We’ve kept the corporate infrastructure lean and tried to erase status differences between management and other organizational levels. Everyone wears a name tag with his first name on it and we address each other by first name. No one has a fancy office with a couch or private toilet... That’s all part of our culture.”** *Sol Price, founder, Price Club, February 1989*
- **“You have to be initiated slowly into the Price Club culture to be able to work around here.”** *Ted Wallace, COO, Price Club East Coast, December 1988*
- **“I look for three I’s in an employee--integrity, industry and intelligence. Of the three, integrity is the most important. Not only in terms of technical honesty, but also in terms of intellectual honesty. I do criticize. People who know me know it’s with affection. It’s my attempt at teaching--you’ve got to keep teaching. I get upset when managers say they’re going to train a new employee; you train a dog, you teach a person. And if you teach them, they’ll understand why something is done instead of having a rigid attitude.”** *Sol Price, August 1988*
- **“The company runs an internal training program for employees called, The Costco Wholesale Perspective. The program provides employees with an overall view of the company philosophy, background and operations. This ensures Costco engages employees who are well-informed representatives of the company. Costco employees can also boast of being among the best paid in retail and the company prides itself on a low staff turnover at about 20% a year, well below the retail industry average.”** *Commerce Business, April 1998*
- **“Generally speaking, the larger a company becomes, the more committed it is to its own concept and the less flexible it becomes... I don’t happen to believe in procedures. We have a few things written down here, but we try as much as possible to create a basic framework within which people can make their own decisions... I wouldn’t feel comfortable in a company where people behave according to what’s written in a procedures manual... It’s maintained in various ways... by this plain office, my attire [tie-less, slacks and sweater], by treating people with respect, by being open to suggestions, by being friendly – using first names. We don’t want to differentiate any more than we have to between hourly people and management.”** *Robert Price, President, Price Club, April 1989*

6. HUMAN RESOURCES – DEPTH

Costco works hard to develop management from within the company

- Internal development: 63% of Costco's club managers started as hourly employees
- 13% of the workforce is unionized
- "Frankly, we haven't had much luck bringing in outside managers. It takes a while to become a part of our culture, and we like to promote from within." *Sol Price, founder, Price Club, November 1990*
- "For each of the 367 or so warehouse managers we have, we have at least eight to 10 salaried, functional managers under that person at each location, with one or two of them having been through the various functional areas of responsibility within the warehouse, from receiving, to front-end, to membership to merchandising. So we think we are well prepared for continued expansion from a managerial standpoint." *Richard Galanti, CFO, Costco, September 2001*
- "[A management restructure] will help us by allowing increased cross fertilization of ideas while allowing younger people to handle more responsibilities. We can take new approaches in different classifications. For example, a hard lines manager can be shifted to soft lines; an administrator can be shifted to operations. By doing so, those people gain a better understanding of all aspects of the company. Specialization has become a problem in our society - it happens with doctors and lawyers as well." *Sol Price, founder, Price Club, March 1989*
- "Management is adamant about limiting expansion to its ability to "grow" management, mostly warehouse managers." *Ed Weller, analyst, ThinkEquity, December 2003*

6. HUMAN RESOURCES – REWARD

Managers are paid well and participate in an excellent bonus scheme

- “PriceCostco has a yearly bonus plan, 50% of which is tied to individual goal criteria including gross margin, shrink and other measures, depending on what aspect of merchandising or operations the employee is involved with. The remaining 50% of the company’s bonus incentives are tied to the company hitting its pretax profit goal. Bonuses as a proportion of total compensation are typically less than 20%. The program’s reach includes senior and junior officers, each warehouse manager, and about 50-100 corporate managers and buyers. PriceCostco also allocates stock options to these same individuals.” *Salomon Brothers, July 1996*
- “Jim Sinegal’s \$350,000 salary last year was practically cause for drumming him out of the Fortune 500 CEO club; and at his own request, he took no bonus for the third consecutive year. He does have \$16.5 million worth of options, but he's intent on capping his salary and bonus at about twice the level of a Costco store manager [i.e. \$175,000/year].” *Fortune, November 2003*

6. HUMAN RESOURCES – VS WALL STREET

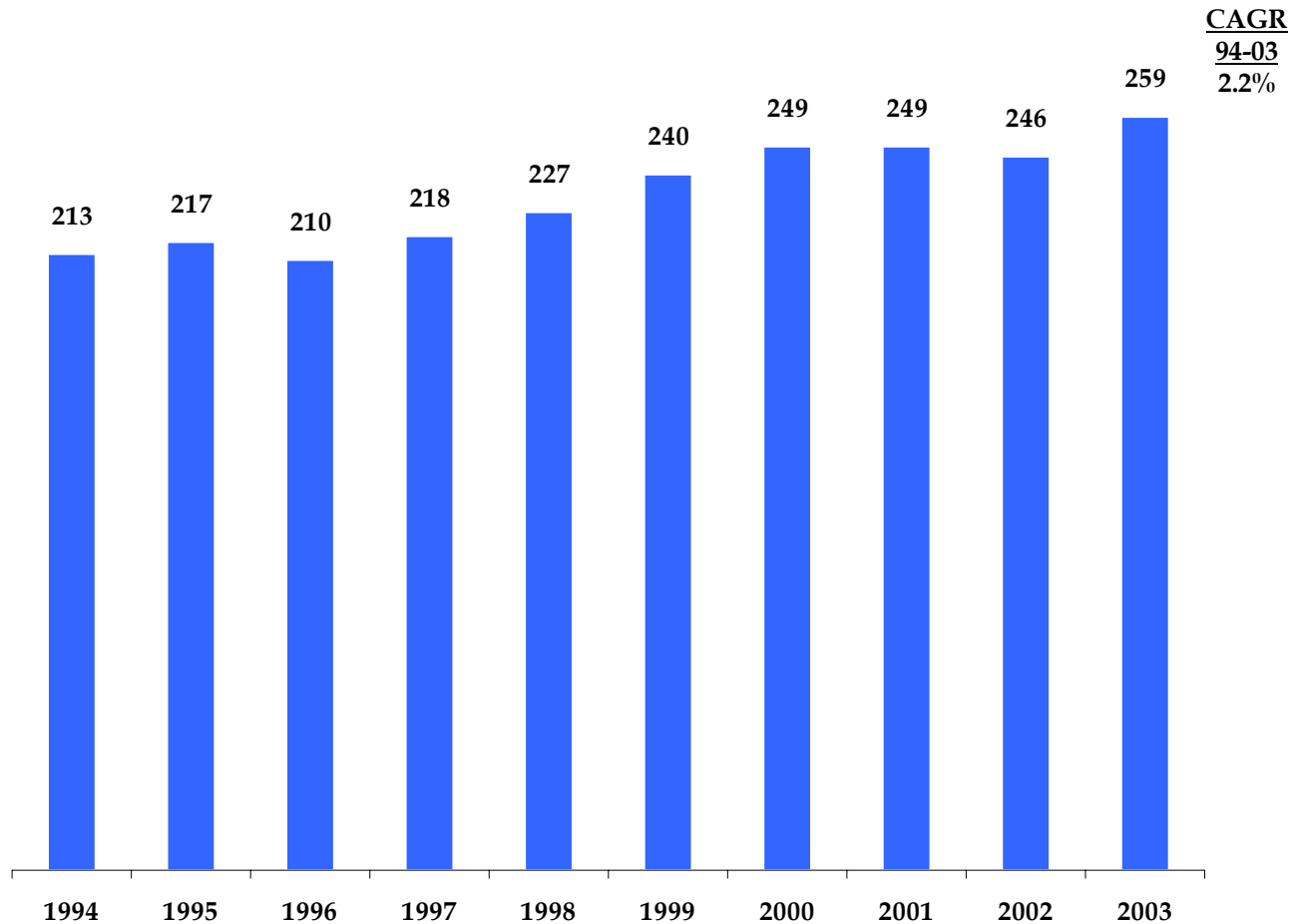
Wall Street currently believes Costco is too generous to its employees

- **“The last thing I want people to believe is that I don't care about the shareholder. But I happen to believe that in order to reward the shareholder in the long term, you have to please your customers and workers... They're entitled to buy homes and live in reasonably nice neighborhoods and send their children to school... You've got to want to get the very best people that you can and you want to be able to keep them and provide some job security for them. That's not just altruism. In the final analysis, it's good business.”** *Jim Sinegal, CEO, Costco, March 2004*
- **“I think they are a company that proves you can treat your employees well and still be successful. Most companies are only interested in the bottom line.”** *Rome Aloise, Teamsters union representative, March 2004*
- **“We think when you take care of your customer and your employees, your shareholders are going to be rewarded in the long run. And I'm one of them; I care about the stock price. But we're not going to do something for the sake of one quarter that's going to destroy the fabric of our company and what we stand for.”** *Jim Sinegal, CEO, Costco, Nov 2003*
- **“Costco has long been very liberal with employee benefits, partly because good benefits helps the company hire and retain better employees and partly because the company believes it is simply the right thing to do. Costco wants every employee covered, too, and requires those who choose not to participate to prove they are covered under a spouse's plan.”** *Ed Weller, analyst, ThinkEquity, December 2003*
- **“From the perspective of investors, Costco's benefits are overly generous. Public companies need to care for shareholders first. Costco runs its business like it is a private company.”** *Bill Dreher, analyst, Deutsche Bank, March 2004*
- **“Their benefits are amazing, but shareholders get frustrated from a stock perspective.”** *Emme Kozloff, analyst, Sanford C. Bernstein, March 2004*

6. HUMAN RESOURCES - EMPLOYEES PER CLUB

The number of employees per club is trending upward

Employees per club
People, actual, FY 1994-FY2003



7. LEADERSHIP

Costco is recognised as having a strong leadership team

- **"We're in a state of healthy paranoia. We've succeeded by being a moving target, by hitting them where they ain't. We need constant reminders to keep us on our game. I say at our management conferences that the amount Wal-Mart grows in just one year is the equivalent of Costco's size." *Jim Sinegal, CEO, Costco, November 2003***
- **"This company is unusual in much more than its format. It boasts an innovative management team that is never satisfied, always searching for new product and processes to lower costs. Costco is driven by the productivity loop and the company is constantly driving to reduce costs and pass the savings on to its customers. In our opinion, Costco is one of the best-managed companies in the industry with a management team that knows how to execute and is constantly innovating." *Jonathan Ziegler, analyst, Deutsche Bank, May 2000***
- **"The company promotes from within. Other than through the Price merger no outsider's entered directly into senior management in at least ten years--even as sales grew tenfold. Insular? "We reflect on that," says Sinegal. "We have been fairly inventive, and people who are so insulated are not typically as inventive." For sure, Sinegal and his troops prowl the retail competition's offerings relentlessly. With virtually no bureaucracy, there are few formal meetings. No official memos. Scant corporate politicking. The company doesn't seek attention (have you read a profile elsewhere?), so there's no press or investor relations staff--although Chief Financial Officer Richard Galanti might phone the papers to see that sales figures get a mention in retail roundups." *Forbes, August 1997***
- **"Costco has a deep management bench that prides themselves on innovative ideas and is excellent at execution." *Emme Kozloff, analyst, Sanford C. Bernstein, January 2001***

7. LEADERSHIP

Jim Sinegal is widely credited as the driving force behind the company

- **"Here's the difference between Sam's and Costco: We have a live Sam Walton who's still there, and Wal-Mart doesn't."** *Charlie Munger, Berkshire Hathaway vice chairman, Costco shopper, investor, and director, November 2003*
- **"The biggest risk in that whole picture is Sinegal. If something happened to Jim, that would be a bad thing."** *Sol Price, August 1997*
- **"The one man Wal-Mart fears doesn't seem fearsome in person. At 66, he has hair as thin as his company's margins, and he seems more like a twinkle-eyed grandfather (which he is, eight times over) than a killer retailer... Costco is driven by principles and ethics that you probably thought went the way of the five-and-dime. Sinegal reinforces them by traveling 200 days a year, trying to visit every store twice annually. He's got energy that leaves people half his age floundering in his wake. (Must be the near-daily racquetball games.)... "What's hot? What's Sam's beating us on? Have you seen that item in Best Buy? Don't you think we should have that?" All the while Sinegal scribbles notes that, upon his return to headquarters, will become the basis of memos and more questions that he will fire off in all directions."** *Fortune, November 2003*
- **"History is going to write that Sinegal and Brotman were the best merchandising duo since Marshall and Field or Sears and Roebuck. They have created a long-lasting management culture that their job is never finished."** *Dick Outcalt, Outcalt & Johnson Retail Strategists, July 2003*
- **"Getting in touch with the head of a Fortune 50 company typically involves a middleman or two. Not so with James Sinegal, chief executive of Costco Wholesale. The CEO of the nation's largest warehouse club... returns a message left on his voice mail the very next day and, within five minutes, a visit to Costco's headquarters in Issaquah, Wash. is scheduled. Jim Sinegal is all about eliminating the middleman."** *Money, August 2002*
- **"At Costco energy springs directly from the source in Sinegal. When he is not in the field, which is 40% of the time, he is within easy reach, operating from an open-walled office that allows trouble or opportunity to find him at any time. With virtually no bureaucracy, the President does not wear a tie, or a watch, (he believes minding the store requires neither) and most of the time he answers his own phone. There are few formal meetings, no official memos and few company politics."** *Commerce Business, April 1998*

SECTION 4: SELLING TO COSTCO

This section is designed to help manufacturers understand the buying function works at Costco and how to sell to them



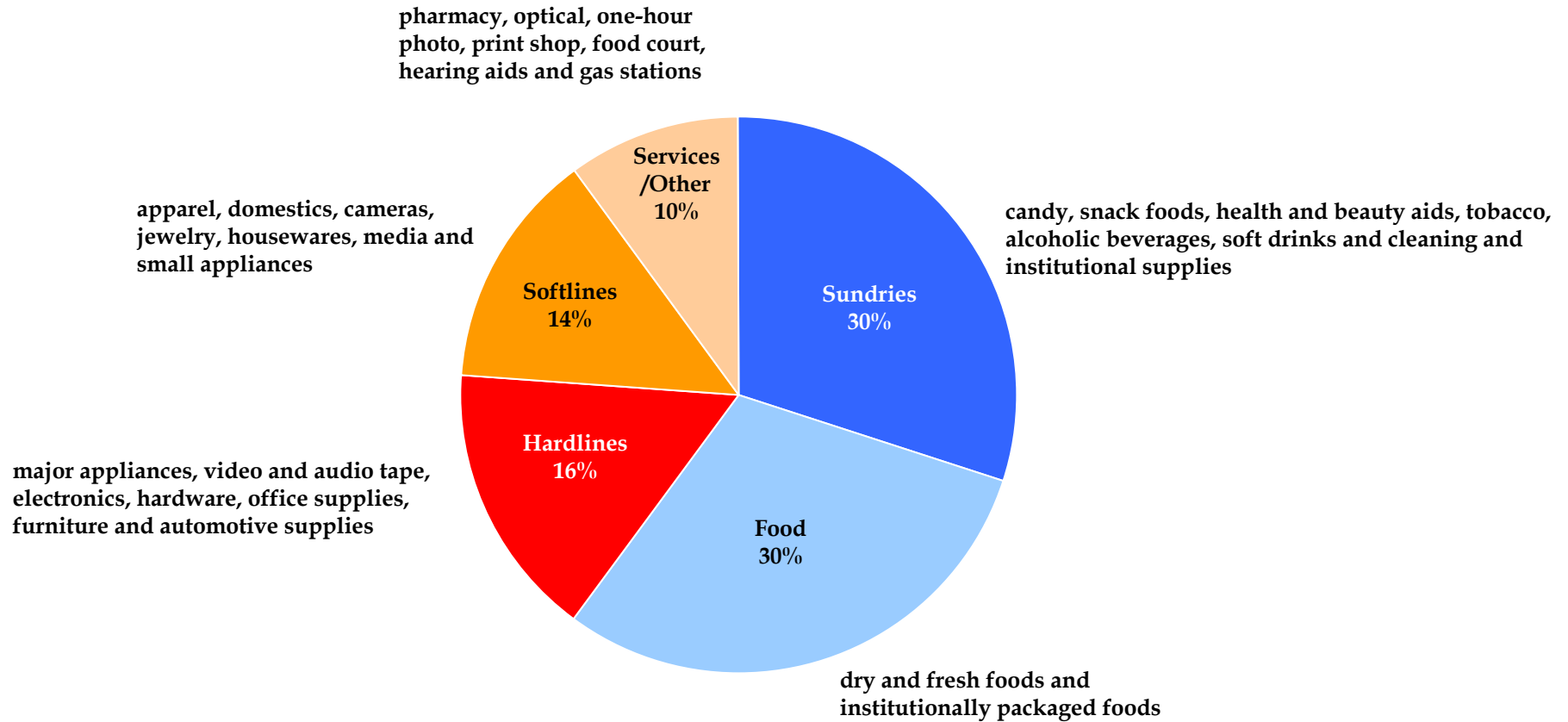
“A drayman in a Russian village, barely made enough money to buy hay for his horse so he tried to cut costs by putting a little more straw in the horse's feed each week. After the eighth week the horse dies. The owner complains bitterly to a friend that just about the time he had the horse trained to eat straw, it died on him. And a lot of merchants will do something similar. They'll bring in merchandise that isn't quite as good as they used to offer, but which gives them a better margin and then they can't understand why their business died.”

Sol Price, founder, Price Club, February 1989

SALES BY CATEGORY

Costco sells products across five main categories: sundries, food, hardlines, softlines, and services

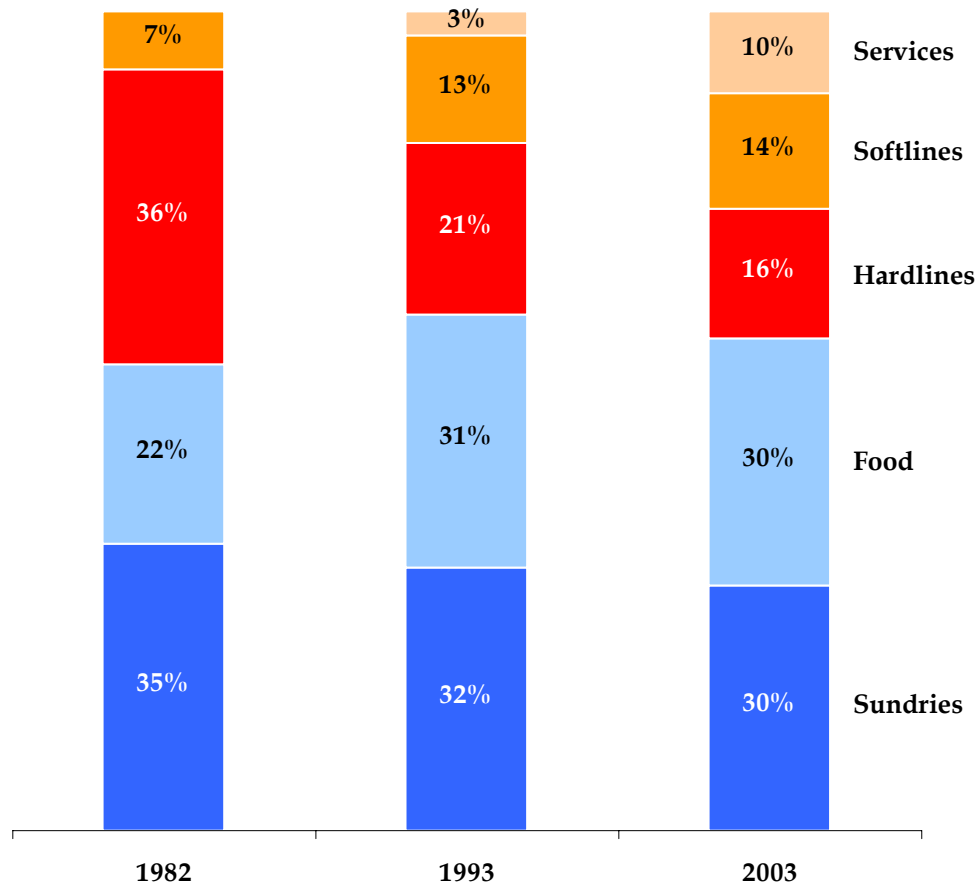
Price/Costco sales by category
%, 2003



CHANGE IN SALES MIX

Over the past twenty years, the mix has shifted towards supermarket related food and sundries and services and away from department store related hardlines and softlines

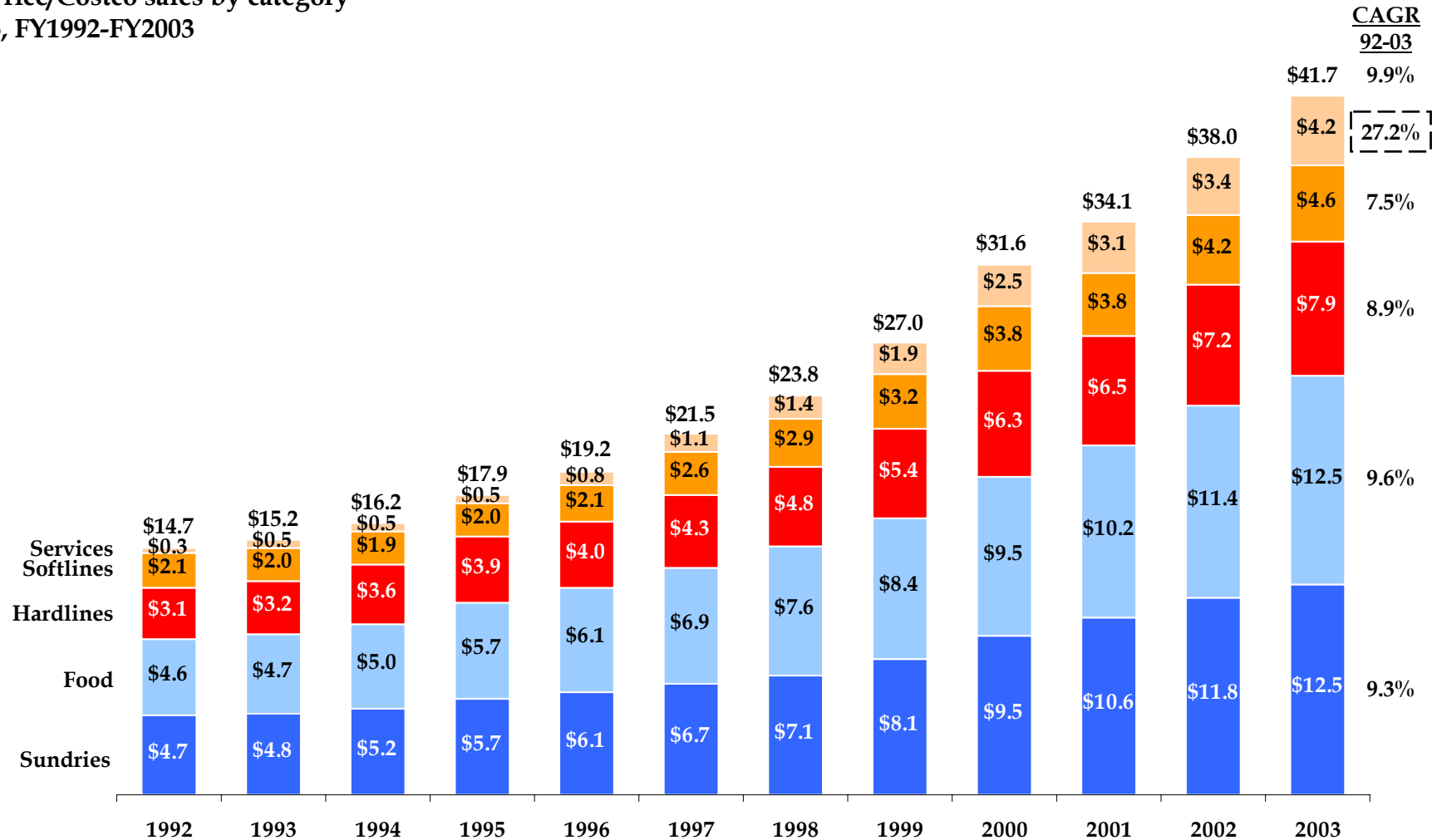
Price/Costco sales by category
%, 1982-2003



GROUP SALES GROWTH BY CATEGORY

While all categories have shown strong growth over the past decade, the services/other category has been the standout

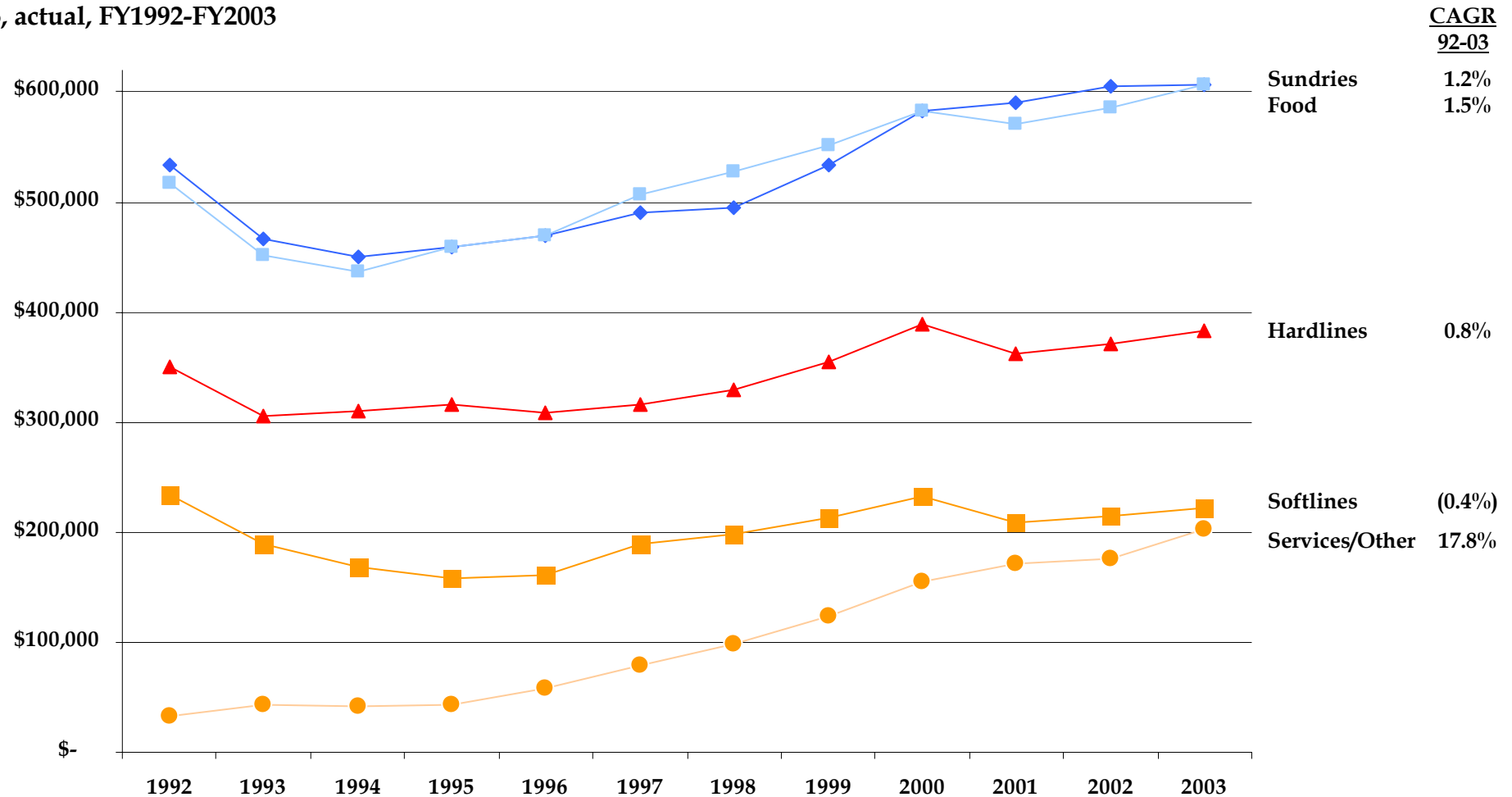
Price/Costco sales by category
\$, FY1992-FY2003



SALES PER STORE PER WEEK

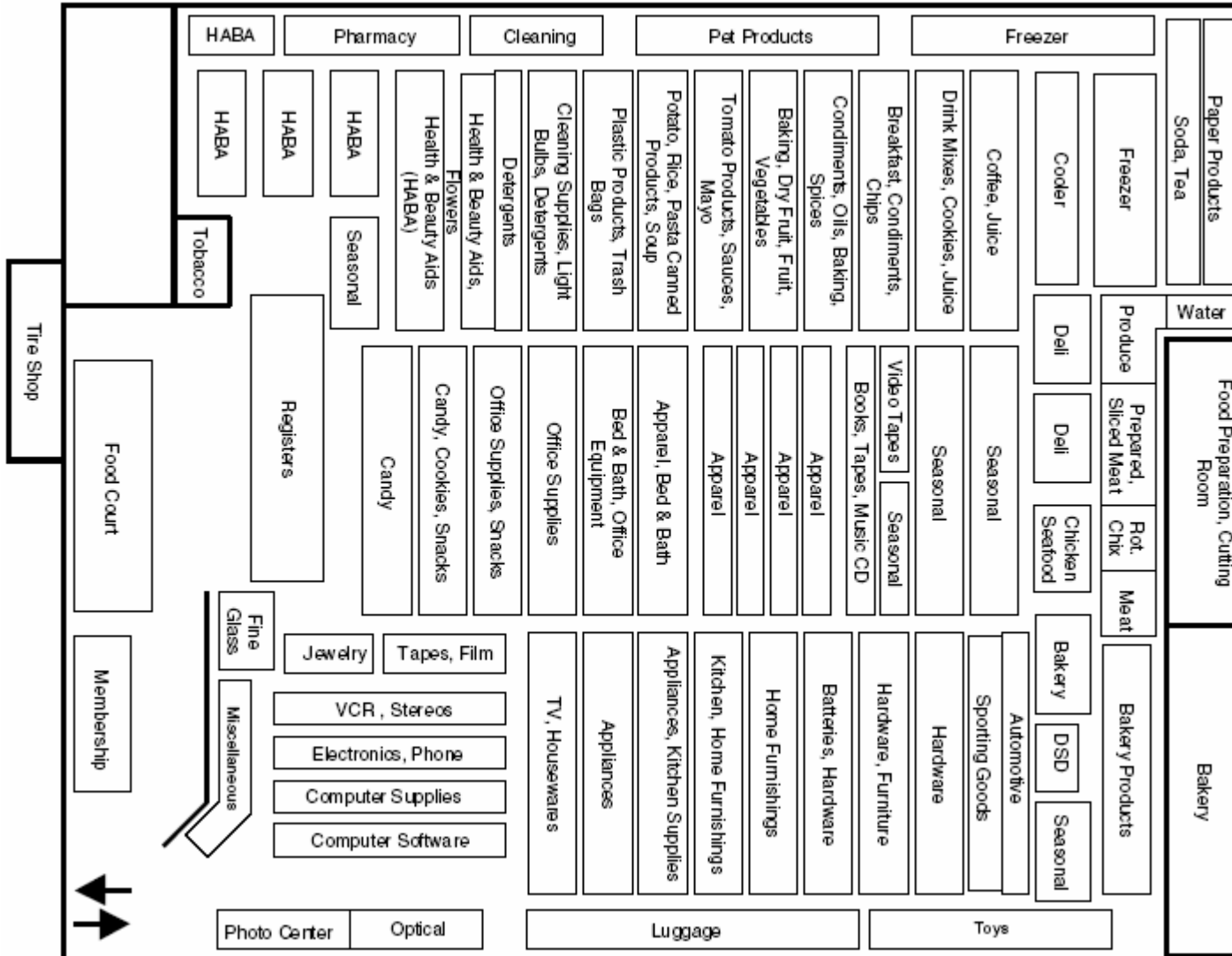
On a per store basis, categories other than services have struggled to grow

Average Costco store sales per category per week
\$, actual, FY1992-FY2003



STRONG WIDTH OF RANGE

Costco offers a strong width of range across diverse product categories from candy to jewelry



LIMITED DEPTH OF RANGE

Costco offers a limited depth of range carrying only 4,000 items for sale at any one time

- **“As a rule of thumb, a retail business generates 80 percent of its sales on 20 percent of its merchandise. Our concept is to zero in on the most sought-after items, to quite literally limit our merchandise assortment to the 20 percent, and to make the 100 percent of our sales on that 20 percent.”** *Henry Halmsohn, President, Pace Warehouse, May 1985*
- **“The temptation to add sku's is one of the most terrifying aspects of this business. We must constantly remind ourselves that we are not in the full-line retail business. We need to take an 'intelligent loss of sales' instead of broadening our assortment in order to compete.”** *Walter Teninga, President, The Warehouse Club, November 1983*
- **“This game requires discipline. Costco must be willing to forgo many items customers may want--low-fat this or that, for example. Instead Costco focuses on relatively higher priced goods that it can price competitively and build repeat business... Costco bakeries don't sell basic white bread, because margins are already so low there isn't much room for Costco to improve on them.”** *Forbes August 1997*
- **“Costco offers about 3,600 active items compared with a typical supermarket that might carry about 25,000 items. We have a wide range of categories - pianos to Rolex watches and 100-pound bags of rice - but they all represent quality national brands and that helps us to nearly eliminate advertising costs, which are almost nil. By offering large sizes, Costco provided substantial price savings on all merchandise... We've brought better quality, higher ticket and larger sizes to our members, as well as services.”** *Richard Galanti, CFO, Costco, May 1990*
- **“They typically don't offer the depth of merchandise that retail stores do. For example, an appliance superstore may sell some 15 different microwave ovens; a warehouse store may stock three or four, each in different price ranges. Larger inventories are kept only on items that will sell quickly, such as soda pop or laundry detergent. And brand names change often, based on what the club can buy most cheaply: one week, the most heavily stocked detergent could be Cheer, the next week, Wisk.”** *Chicago Sun-Times November 1989*

HIGH VOLUME PER ITEM

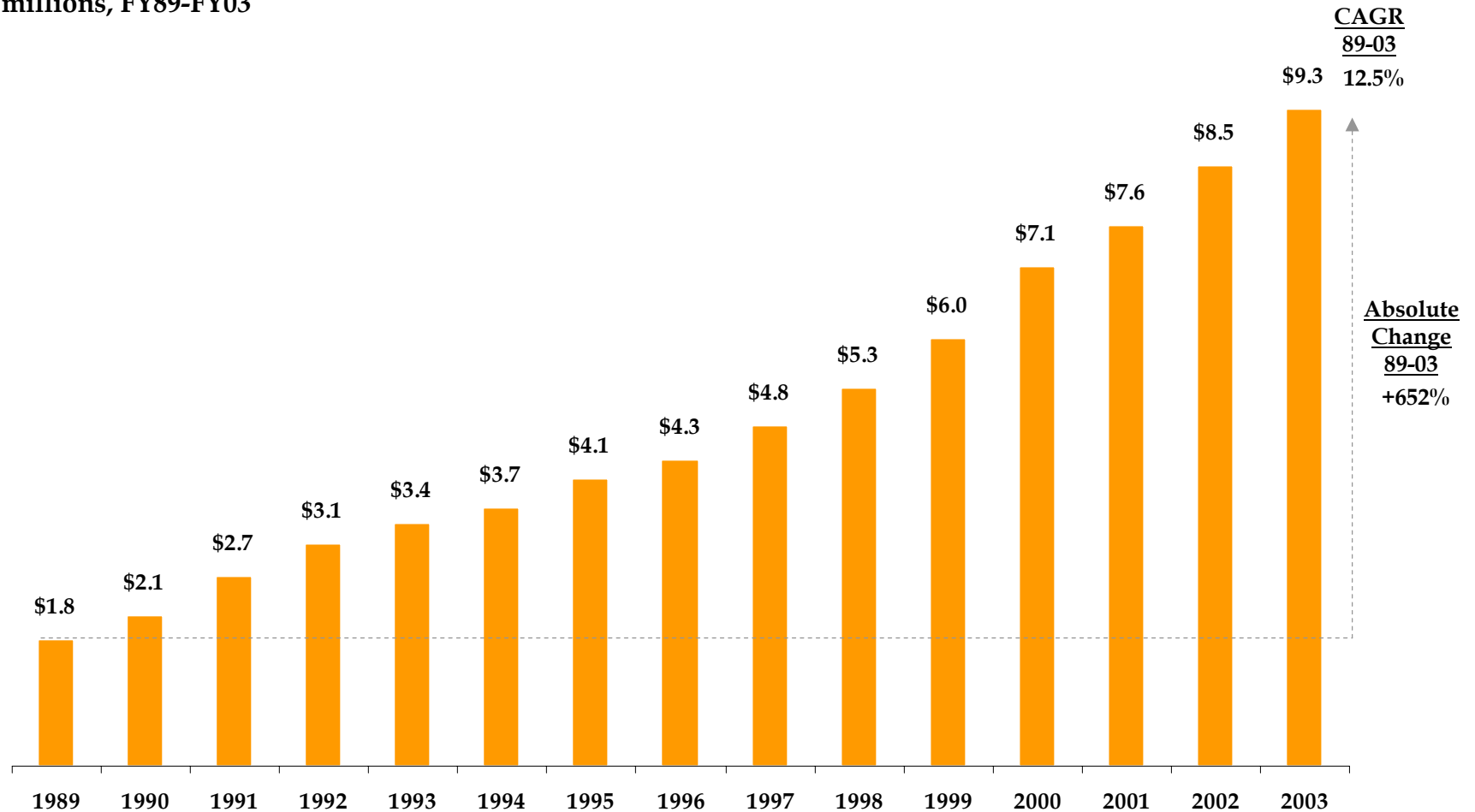
Costco focuses on driving the most sales volume through these 4,000 items

- “If you want to introduce a new item, and you aren't buying it in sufficient quantities to buy it right, you should price it as though you were buying it right instead of basing your price on cost. Let me explain. Suppose we are selling a fountain pen. You could get the right price if you bought 10,000 gross of pens, but you're not sure you can sell them, so you buy only one gross. Obviously, buying one gross doesn't get you anywhere near the right price. But if you price the pen on the basis of what you paid for it - the one gross cost instead of the 10,000 gross cost - you will never find out how much volume you could do if you priced it right. Price it as though you were buying it right, and then you'll find out whether can do the buying right.” *Sol Price, founder, Price Club, November 1990*
- “Our task is to sell high volume of a few items.” *Richard Galanti, CFO, Costco, June 2003*
- “Ultimately, we try to attract more volume at the same costs. To do that, we have to be a good operator, reduce expenses, shrink and payroll. You also have to be a good merchant.” *Richard Galanti, CFO, Costco, November 2001*
- “As more people are attracted to more locations to spend more money, the warehouse operator is able to command ever-better deals on the tightly limited range of items that it carries. Down go the prices of Costco's goods, which puts top brands and occasional specials like Callaway golf clubs and Cannondale mountain bikes in the eager hands of the aspiring middle class. Once a customer has joined (by evincing a steady livelihood and paying a \$35 annual membership fee), he or she has every reason to shop Costco first. Think of it as compounding yield, only in this case from steadily squeezing unit costs rather than by raising prices.” *Forbes, August 1997*
- “When Costco places an order, its number can be staggering. For popular items like trousers or shirts, it doesn't bat an eye ordering 500,000 pieces at a time.” *Seattle Times, July 1997*
- Costco sells 15% of all olive oil sold in the United States

PURCHASES PER SKU

Costco's strong sales growth has massively increased its implied annual purchases per sku

Merchandise purchases per effective sku assuming 4,000 skus
Dollars, millions, FY89-FY03



INVENTORY TURNS

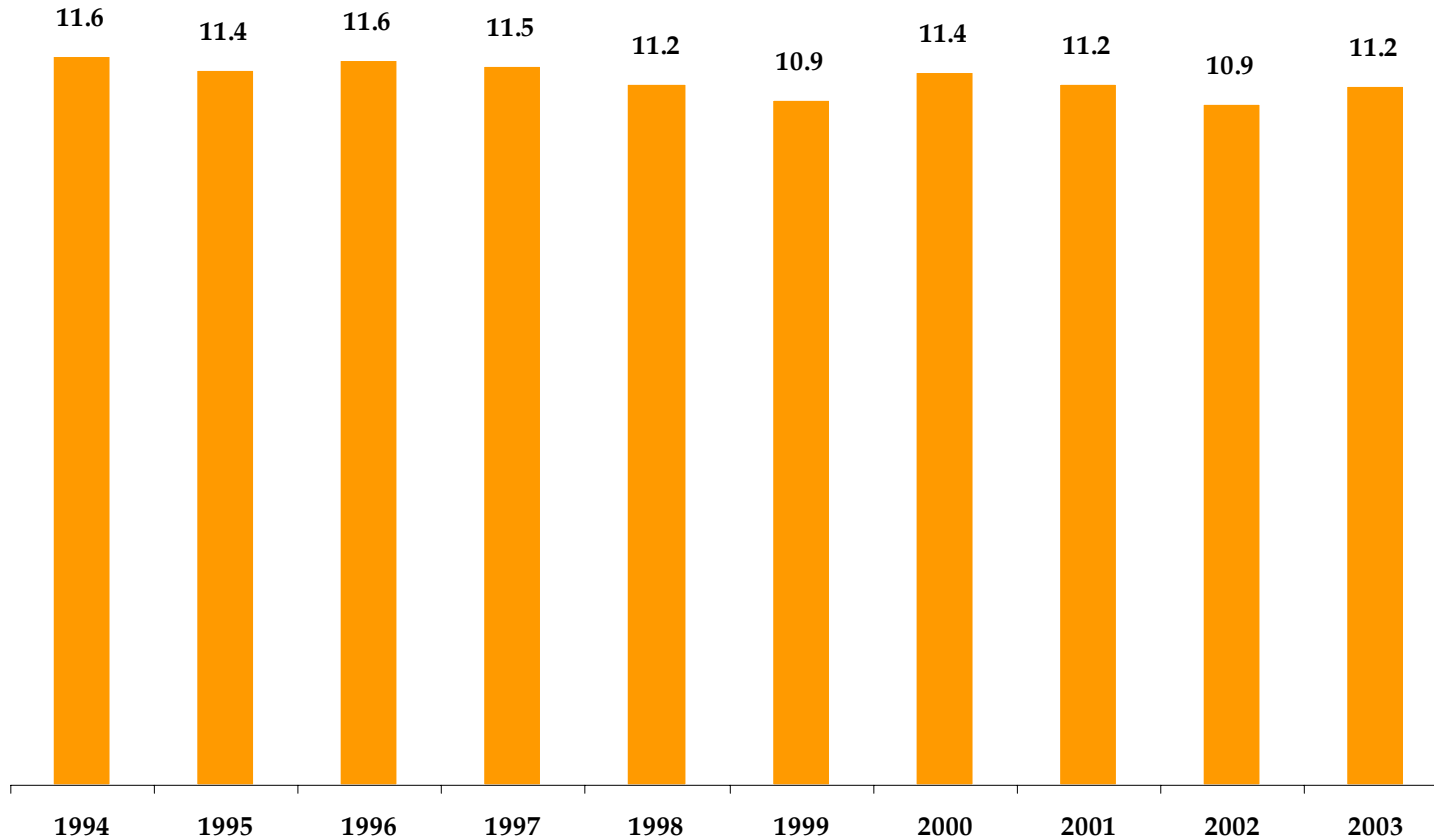
High volume across a limited range leads to strong inventory turns

- “With old and new members flocking to the stores, and no slow-moving items on its shelves, Costco turns its inventory over 14 times¹ a year on average—once every 26 days. Home improvement stores turn inventory 4 to 6 times, supermarkets somewhat less than Costco. That high-inventory turn answers another question about Costco, namely, how can a \$22 billion company operate on what was barely \$110 million in working capital at the end of 1996? Home Depot has about the same revenues as Costco, but requires over \$2 billion in working capital—and Home Depot is no sluggard. With its goods moving so quickly off the trucks and out its doors, Costco doesn't need much working capital. It is largely financed by its vendors. Note this: Costco's accounts payable currently equal 80% of its inventory. At Wal-Mart the ratio is about 48%.” *Forbes August 1997*
- "The market share of the clubs in certain major branded commodities is staggering: one major manufacturer told us that Price Club alone accounts for 20 percent of the manufacturer's case volume in the Los Angeles market in a certain well-known household chemical brand and this volume comes from 13 warehouses, versus 100 or more store each for K mart, Lucky, Ralphs and Vons in southern California... There are only so many Shop-Vacs or 300-piece Allied tool sets that an individual will buy, but breaded catfish fillets -- that's another story." *Stephen Mandel, Analyst, Goldman Sachs, August 1989*
- “But the limited selection creates efficiency. Successful stores turn over inventory 15 to 18 times a year, compared with four times a year for the average retailer. Less capital is tied up in inventory, and fixed costs are spread over greater sales. That, coupled with the low overhead and membership fees that run about \$25 a year, allows the clubs to operate on 10% gross margins, compared with 30% for the average discount store.” *Business Week, March 1985*
- “Profits depend on high volume and huge cash flows. The busiest outlets have annual sales of as much as \$100 million and turn over their inventories 15 or 16 times a year, compared with perhaps five times for traditional department stores. Warehouse clubs buy their merchandise on credit and sell it for cash.” *Fortune, December 1984*

INVENTORY TURNS

Costco turns its inventory over more than 11 times per year

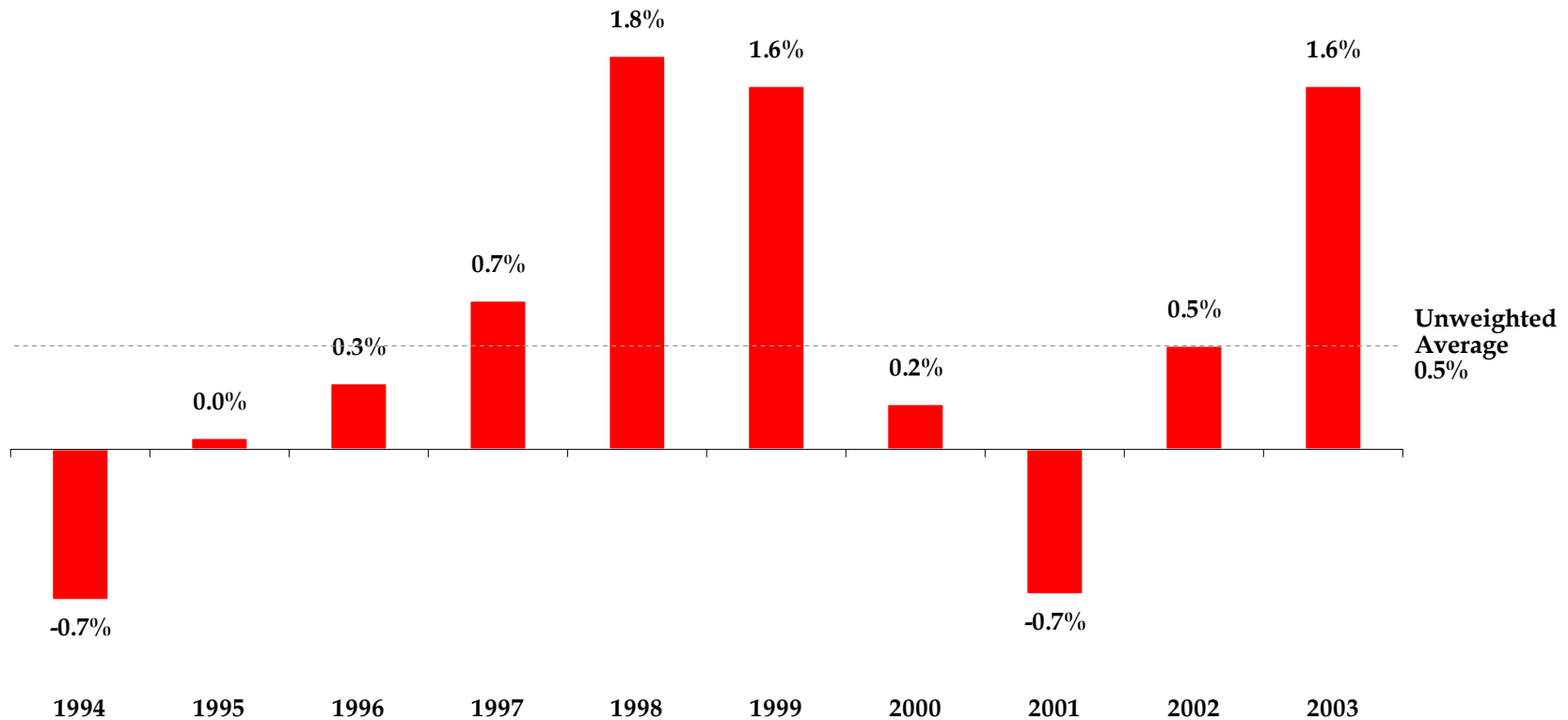
Costco's inventory turns (cogs over inventory) by year
Turns, FY94-FY03



WORKING CAPITAL EFFICIENCY

High inventory turns and an efficient business lead to low use of working capital

Costco's working capital as a percent of sales by year
%, at end of FY, FY94-FY03



LARGE PACK SIZES

Reflecting its small business customer base, Costco focuses on selling in large pack sizes

- **“Bulk food buying at Costco will mean two cauliflowers or loaves of bread rather than one: 5lb packs of meat, trays of 18 cakes, 24 beefburgers, and large office-style jars of coffee, gallon jars of mayonnaise.”** *Paul Moulton, Managing Director, Costco Europe, November 1993*
- **“To keep the warehouses running efficiently and to promote quick sellouts, operators typically stock only about 3,500 products, compared with more than 25,000 in the typical supermarket. That means only one or a few brands of each product are carried, usually in one large size, like five-gallon jars of mayonnaise and packages of five dozen eggs. The bigger sizes are a better deal for those who need or can use them, like restaurant operators.”** *New York Times, Dec 1990*
- **“Are you in the market for a summer-camp-sized tub of peanut butter? Or perhaps a lifetime supply of panty liners? Maybe you are tantalized by one of the shiny new wheelbarrows stacked high to the ceiling or can't resist the outrageously cheap DVD player? But more than likely, you, like many of the other Costco customers, will at least buy an industrial-sized package of toilet paper, the consistently number-one selling item at Costco Wholesale Corporation's hugely popular discount-shopping warehouses.”** *Costco profile, Infotrac, March 2004*
- **“By our observation within the clubs, the majority of this incremental business is clearly being purchased for personal use, whether by business or group members. The clubs have not reduced packaging sizing in these categories, nor have they taken on a broader assortment. Consumers have merely begun to more broadly perceive the value of buying, for personal use, Tide detergent in a 25-pound box, paper towels in 12-packs, or Stouffer's frozen lasagna in a food service six-pound size.”** *Stephen Mandel, Analyst, Goldman Sachs, August 1989*
- **“A person looking for mayonnaise might find only the jumbo size. Brands of television sets often change from week to week, depending on where the store finds the best buys.”** *Business Week, March 1985*

EXAMPLES OF CLUB PACKS

Costco demands products in large pack sizes



DISPLAY-READY

The company doesn't use manufacturers fixtures and is particular about display-ready packaging

- "We don't utilize special vendor fixtures for items, and have not carried items because we couldn't agree on the best way to merchandise them." *Jim Sinegal, CEO, Costco, November 1988*
- "Stocked items are placed directly onto the selling floor or are still stacked on their pallets, reducing handling and stocking labor... Warehouses are almost entirely self-service, from finding and buying items, to loading them into a customer's vehicle." *Costco profile, Infotrac, March 2004*
- "Chief Executive Jim Sinegal worries that small products like premium-grade Gillette Sensor razor blades will be targeted by shoplifters. Thus, Gillette's John Johnson says, Costco "asked that we strengthen the product" with ripoff-resistant packaging. When shrinkage is shrunk both consumers and Costco benefit." *Forbes, August 1997*

EXAMPLE: DISPLAY-READY PALLETS

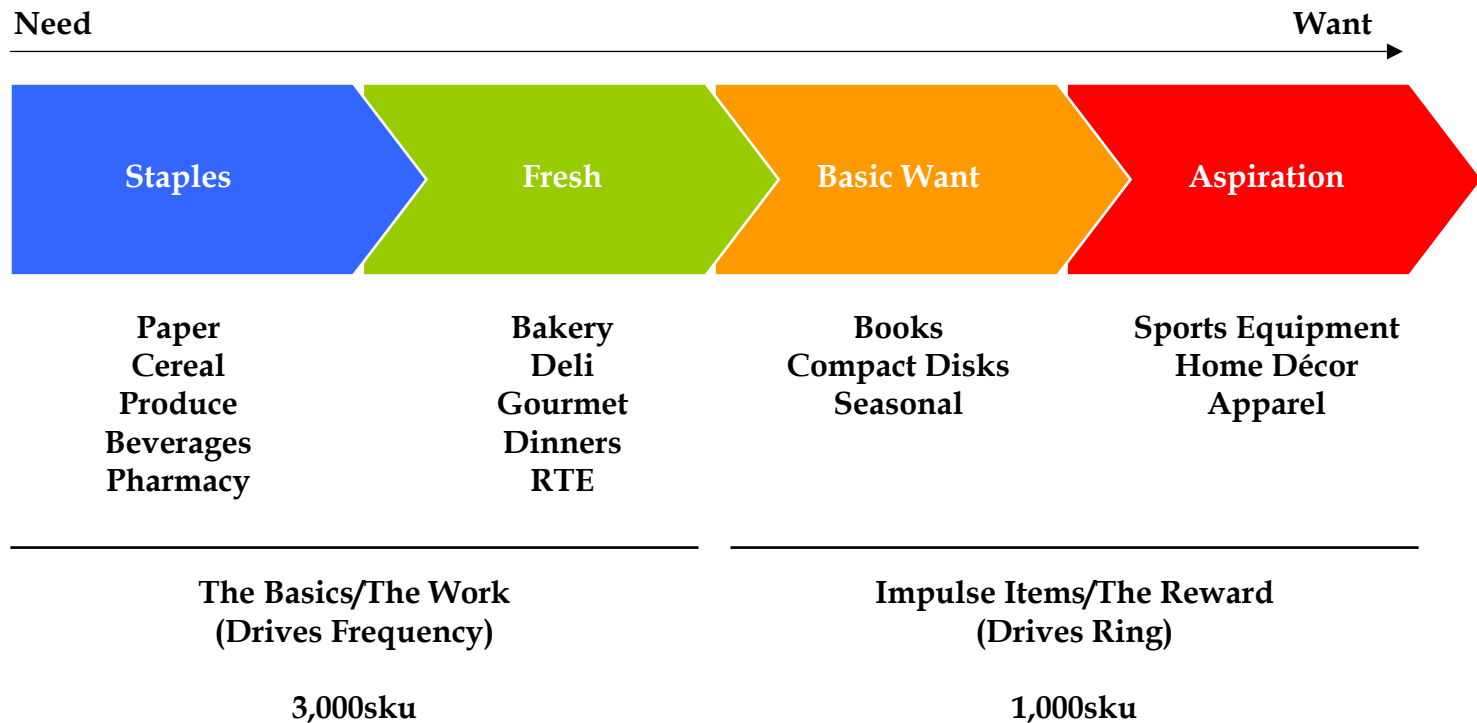
Costco demands items arrive on display-ready pallets



ASSORTMENT STRATEGY

Costco’s merchandising strategy is based on getting its members to visit for “need-based” items and once there getting them to purchase additional impulse “want-based” items

Costco’s assortment strategy Model



ASSORTMENT - THE BASICS

Costco offers about 3,000 skus of relatively consistent merchandise...

- **“Some of the items offered in Price Club outlets are stocked only when they can be bought right. Other staples have to be stocked consistently, because your customer has a right to expect to find them every time he comes in. If you want to be in the office supply business, you have an obligation to have copy paper in stock; to run out is inexcusable. On the other hand, you might bring in some fashion or seasonal merchandise - a sweater or Christmas toys - that you should run out of. Maintaining stock is a matter of implementation, and some people are better at implementing than others. It's easier said than done. I used to say the only basic every retailer never runs out of its excuses.”** *Sol Price, founder, Price Club, November 1990*
- **“We have a product selection of about 4,000 items; if you went into a Target or Wal-Mart, you'd find around 100,000 items. We may only select two toasters to sell, or two types of peanut butter, but those will be the best values that we can find at that moment. Those items make up about 3,000 of our selection.”** *Jim Sinegal, CEO, Costco, August 2002*
- **“But of our 4,000 items I'd says 3,000 are continuous. However, you might see gallons of one product brand today, and tomorrow another brand in the same product. Our customers must be prepared to give up brand loyalty for a deal in other quality goods.”** *Jeffrey Brotman, Chairman, Costco, September 1985*

ASSORTMENT – IMPULSE ITEMS

... and about 1,000 skus of opportunistic impulse lines

- **“We will sell anything apart from live animals.”** *Paul Moulton, MD, Costco Europe, June 1993*
- **“About 25% of the entire mix is opportunistic or seasonal, by which we mean that one week we might buy Reebok sneakers, and the next week Calvin Klein jeans. Or it might be a special deal such as Watford crystal. At the same time we have certain regular slots.”** *Jim Sinegal, CEO, Costco, November 1988*
- **“About 1,000 items are constantly changing. One week the customers see some Levi's relaxed-fit jeans and some Waterford crystal; they come back the next time, and we don't have those items, but we have Tommy Hilfiger and Baccarat. It creates an attitude that if you see it, you better buy it. Don't misunderstand me, people really like saving 50c on a jar of peanut butter. But what they really love is to see a Movado watch for \$250 that sells for \$550 in the jewelry store. That's the conversation of cocktail parties. Peanut butter is not.”** *Jim Sinegal, CEO, Costco, August 2002*
- **“Warehouse club customers do not instinctively have top-of-the-mind awareness that a warehouse club indeed may be the best place to buy a watch, a canoe or a rug. The value integrity of the clubs, however, becomes so strong that members implicitly believe in the quality and value offered by the clubs in these non-commodity items and develop the instincts to seek out these type of items when they are shopping in a warehouse club.”** *Stephen Mandel, Analyst, Goldman Sachs, August 1989*
- **“They may go in for a steak, but they probably come out with a bottle of booze and a TV set to boot.”** *Bo Cheadle, analyst, Montgomery Securities, May 1990*
- **“Yes, and for whatever reason you're coming into a Costco, whether it's the pharmacy, or the steaks, or the fresh foods department, or photo processing, or whatever it might be, while you're there you're going to pick up something else. And that typically might be something that you may have bought elsewhere had you not visited and seen it at Costco.”** *Richard Galanti, CFO, Costco, September 2001*
- **“We find things there that we don't find in regular grocery stores, like frozen crème brulée and onion soup bread bowls.”** *Bonnie Royle, customer, Costco, quoted in USA Today, June 2003*

TREASURE HUNT

The opportunistic lines are a key part of Costco's "Treasure Hunt" merchandising scheme

- "Our customers don't drive 15 miles to save on a jar of peanut butter. They come for the treasure hunt." *Jim Sinegal, CEO, Costco, November 2003*
- "Every week there's a surprise of some kind that wasn't there last week. We might find a good buy on Oriental rugs or computers and put them right out in front. In the beginning, we never dreamed that Price Club would be an exciting place for people to shop, but that's the way it's turned out in many of outlets: a shopping adventure. We do make it a trademark to offer a few very unusual items at the best price anywhere. For example, we have been featuring Dom Perignon champagne at \$52.79 (priced at over \$75 in most liquor stores." *Sol Price, founder, Price Club, November 1990*
- "That sense of shopping-as-adventure has been a key part of Costco's success... One-quarter of the merchandise is being rotated every week, and people like the treasure-hunt mentality of going to a club store. It's going to a branded-goods garage sale with goods you want to buy." *Neil Cherry, partner, Bain & Co., July 2003*
- "Many of the additional sales being rung up by clubs are coming from the in-and-out retail-oriented products such as books, compact disks, jewelry, sporting goods, toys. Such short-term, sometimes seasonal merchandise, reflecting a need to buy while it's in stock, constantly changes in the clubs. These items, too, are part of the discovery process of warehouse club shopping. It takes a while for consumers in a market to become educated about the existence of warehouse clubs, additional time to understand the values being offered by the format and finally, and most subtle of all, to perceive the tremendous amount of different and exciting in-and-out merchandise that flows through a warehouse over the course of a year. The in-and-out strategy, which meant clubs carried some products for six to 12 weeks at a time, allowed them to show a much larger variety of merchandise, estimated at 10,000 to 12,000 items, over the course of a year, compared with the 3,000 to 4,000 SKUs stocked at all times." *Stephen Mandel, Analyst, Goldman Sachs, August 1989*
- "One of the secrets to our success is the treasure hunt atmosphere that we create. It is the hallmark of our business, the type of thing that we've become known for. Customers love to come in and find those special items, and we know we're doing the best job of merchandising when we have the best treasure hunt atmosphere in our buildings." *Jim Sinegal, CEO, Costco, May 2003*

TREASURE HUNT EXAMPLE

You never know what you're going to find when you go shopping



FIRST IN, FIRST OUT

Costco likes to be “first in, first out” on new or seasonal items

- **“The clubs endeavor to limit markdown exposure, a strategy that is reflected in their approach to seasonal merchandise. Clubs generally stock seasonal items sooner than other retailers and are out of this merchandise by the time others are running their end-of-season clearance sales featuring deep discounts and generating low margins.”**
Sally Wallick, analyst, Legg Mason, Spring 2000
- **Christmas decorations up at the end of August**
- **Three reasons for the first-in, first-out policy:**
 1. **Many members are small businesses buying for resale**
 2. **To have products produced at a down time for factories = better costs**
 3. **Minimise the stock that has to be marked down at the end of the season**

KNOWN BRANDS

Costco focuses on known name brands at the best prices

- "Manufacturers are more willing to sell to us directly. Just in Levi's, we went from perhaps \$10 million or \$20 million to \$150 million a year in Levi's, at a better price to members. We'd like to sell Godiva chocolates and Sony TVs and Estee Lauder and Paul Mitchell." *Richard Galanti, CFO, Costco, July 2003*
- "Through 2001, Costco entered into a number of new relationships directly with branded manufacturers including Levi's, Ralph Lauren Home, Thomasville, Lane, Kitchen Aid and Nautica - to name just a few. Levi's, in particular, is a strong win for the company as Costco will be selling high-volume, fashionable 550 jeans not just leftovers of undesirable designs. Costco's price is considerably less expensive than other retailers. Our checks indicate retail price for these jeans are in the high-\$40s, compared with an everyday low price (EDLP) at Costco of \$21.99." *Janice Hofferber, analyst, Fulcrum, October 2002*
- "Clubs were once dismissed as caverns bulging with everyday items: alarm clocks, bread, paper towels, underwear. However, they've expanded their selection to include higher-end products, such as fragrances by Jean Paul Gaultier, Bose audio, crystal by Waterford and Swarovski and Goodyear tires... Items such as Mont Blanc's platinum Generations pen go for \$98.99. Then, there's the Omega Constellation women's watch for \$2,199." *USA Today, June 2003*
- "Time was when only the great unwashed shopped at off-price stores. But warehouse clubs attracted a breed of urban sophisticates - detractors would call them yuppie scum - attuned to what retail consultant Michael Silverstein calls the "new luxury." These shoppers eschew Seiko watches for TAG Heuer; Jack Nicklaus golf clubs for Callaway; Maxwell House coffee (it goes without saying) for Starbucks." *Fortune, November 2003*
- "Sustained, enhanced focus on high-quality, branded item merchandising: This is the cornerstone of the club business and Costco's strength versus other players, in our view. We think customers shop Costco units for value - translate, high quality for low prices -- not merely price, and remind investors that customers have above-average household incomes. Strength in departments such as apparel, where the Company has returned to higher-end name brands (e.g., Ralph Lauren men's shirts), underscores the members' attraction to quality." *Barbara Miller, analyst, Alex Brown, March 1997*

QUALITY

In order to satisfy its demanding upmarket shoppers Costco must deliver on quality

- **“Wall Street wants your profit numbers to be a little better, so why not just cheat a little bit? Cut down on quality a bit and charge the same price. The customer won't know the difference. It all goes back to the same basic thing: What is your relationship with your customer? Do you feel a personal, professional relationship with your customer, or is it an adversarial relationship? If you can get by cheating a little here or giving a little less than the customer thinks he's getting, is that the way to do it? Or do you give the customer a little more than he's thinks he's getting? That applies to every relationship. Who was it who said it's better to give than receive?”** *Sol Price, founder, Price Club, November 1990*
- **“We focus on providing quality and value. Although we're a club store, it doesn't always mean the cheapest price out there. We're the best value for the best quality.”** *Tim Rose, SVP, food, sundries and fresh foods, Costco, July 1997*
- **“I'm not a big proponent of online auctions. I'm not just looking for the cheapest product I can sell. People come to Costco to buy things cheap, not cheap things.”** *Tim Rose, SVP, food, sundries and fresh foods, Costco, April 2004*
- **“Club buyers will try to get additional features added onto products without increasing the overall cost. Manufacturers presenting products that are bundled with added features that do not increase the cost will increase the effectiveness of their presentations. For example, clubs could sell quilted toilet paper for the same price as non-quilted, include a larger concentration of M&M's in their trail mix or sell a television with picture-in-picture for the same price as a television with out.”** *Warehouse Club Focus, July 2003*
- **“Costco carries only one style of basketball, Spalding's NBA synthetic leather model. It sells for \$13.99, about half what the ball sells for at some other stores. Costco decided on the Spalding ball after cutting it open, measuring the thickness of its outside skin, measuring the depth of its pebbles, and testing the strength of the butyl bladder inside.”** *Doug Schutt, Senior Vice President, Wilson Sporting Goods, July 1997*

TARGETING HIGH END UPMARKET CONSUMERS

Costco's mix is targeted at its upmarket membership

- **"The art form of our business is intuition." Jim Sinegal, CEO, Costco, November 2003**
- **"Costco has enhanced its high-end merchandise by selling such brands as Prada and Gucci, as well as Baccarat and other fine crystals and giftware." Janice Hofferber, analyst, Fulcrum, October 2002**
- **"If a high-end product doesn't move fast, it leaves a lot of money tied up in inventory. Bill Prescott, the chief buyer for consumer electronics, makes some of the toughest judgments about when new products are affordable enough and hot enough to be put on the Costco floor. He sensed the time had come for plasma TVs earlier this year, when the price fell below \$5,000. He placed his order and held his breath. 'You take an educated gamble. If you don't occasionally make a mistake, you're not doing your job.' The TVs turned out to be a hit." Fortune, November 2003**
- **"Warehouse shopping is going upscale. To attract sophisticates, members-only Costco Wholesale is sprucing up its shelves with high ticket wine and fresh foods, such as filet mignon and caviar. The club chain is expanding its high end furniture selection in some stores, too. The plan is to inspire its 19 million cost conscious customers to shell out even more than an average \$103 per visit." Business Week, January 2003**
- **"Costco is now the largest retailer of wines in the country - having sold more than \$500 million in product last year including nearly \$200 million in fine wines. Its buying power helps to sustain the significant price advantage in this segment. Our research suggests Costco wines are at least 25% less expensive than a local wine merchant. In a recent visit, we found bottles of 2000 Far Niente chardonnay for \$39.99 and 1998 Sterling Vineyards cabernet sauvignon for \$36.99 - both over 20% cheaper than a local wine purveyor. Costco also has a number of higher-end labels that normally would sell in excess of \$100 per bottle, but which Costco sells at very attractive prices." Janice Hofferber, analyst, Fulcrum, October 2002**
- **"In terms of trading the customer up, we've cultivated a customer base that buys, in addition to basics, products such as Titleist golf balls, Waterford crystal, and French Bordeaux and Chateau wines. We have become known for these high-end items ' that is, being able to provide not only the basics at great values, but also higher-end merchandise that typically isn't discounted in the retail marketplace." Richard Galanti, CFO, Costco, September 2001**

KIRKLAND SIGNATURE PRIVATE LABEL

Costco also offers a range of private label products under the Kirkland Signature brand, including hair re-growth medicine and dishwashers

Examples of Costco's Kirkland Signature private label



KIRKLAND SIGNATURE PRIVATE LABEL

The Kirkland Signature range is well respected for its product quality

- **“The reason why Kirkland Signature is on every item is because we want to keep that consistency throughout the building. We’ve been able to ensure we’re delivering quality, and over the years, Kirkland Signature has become a brand. We’ve done so well because we’re putting the very best quality in the package. Jim Sinegal feels that instead of fragmenting private label, we should use it as one label. And we’ve been able to instill in people’s minds that when they’re looking at Kirkland Signature, they’re looking at the best quality you can buy at the very best prices.”** *Bill Hanson, General Merchandising Manager, foods and sundries - Midwest, Costco, April 2004*
- **“They've built up their house brand to the point where people are looking for it specifically, because they trust it. That's great evidence of good branding.”** *Cristopher Gunter, President, The Retail Group, July 2003*
- **“We rate Costco’s Private Label efforts as one of the best in the industry. The company now offers more than 400 SKUs, under the Kirkland Signature private label. This now represents approximately 10% of total SKUs accounting for an estimated 12% of total sales. Private label offerings are available in a variety of product categories including diapers, photographic film, batteries, HBC products, cookies, coffee, tires, housewares, luggage, appliances, clothing, paper products and detergent. It should be noted that the company aims to save its members 20% over comparable quality national brands with its private label.”** *Jonathan Ziegler, analyst, Deutsche Bank, May 2000*
- **“Alongside well-regarded brand-name goods, Costco sells more than 200 private-label items, accounting for about 11% of sales. Costco regards its Kirkland Signature brand (Kirkland, Wash. is the former hometown of the company) as a mark of first quality. This not only works with stuff like laundry detergent but also with a good athletic shoe for less than \$20 that is comparable to a Nike selling at easily twice that... Both Costco and its customers win big on private-label sales. At \$9.99 a roll of Kirkland film costs less than half an equivalent roll of Kodak film.”** *Forbes, Aug 1997*
- **“Costco code dates all Kirkland Signature products [fresh, refrigerated, frozen, dry, pharmaceutical or health and beauty aids]. We don’t put a lot of time on any of them because of the velocity of the items we do. We do a good job rotating product, and our biggest concern is that members get the freshest product, even when it’s frozen. We don’t want any product just sitting around.”** *Bill Hanson, General Merchandising Manager, foods and sundries - Midwest, Costco, April 2004*

WORKING TO ACHIEVE TOP QUALITY

Costco works hard with suppliers to make sure its private label is top quality

- **“Batteries are one of our highest volume non-food items. We only have AA batteries because they’re basically 50 percent of a battery business, and they offer great value – 48 Kirkland Signature batteries for \$9.88 vs. 28 national brand batteries for the same price. On the tiered approach of good-better-best, the Kirkland Signature batters are the ‘very best’ from our vendor.”** *Bonnie Busch, General Merchandising Manager*
- **“The first thing we work on is the quality aspect. We ask suppliers for products that are quality - take out the price factor, and we’ll worry about that later. Produce the best quality product for us first, without concern for cost or sell price. Vendors want to come in and price from retail down, instead of cost up. That’s my job to figure out what I want to sell it for. They’ve been so conditioned to hit a price point, but what I want to know is ‘what does it cost you to manufacture with this quality?’”** *Tim Rose, SVP food, sundries and fresh products, Costco, April 2004*
- **“Costco management highlighted... how the company has developed a range of Kirkland Signature products that exceed the specs of the best-quality brands... Among the highlights were fresh (farmed) salmon, skinless and beautifully trimmed, much better-than-the-leading brand canned Albacore tuna (in 8-packs for \$8, about a fourth less than Costco's low price for the brand leader) and the best-available-quality canned salmon (with no solids) and canned chicken breast. One of our personal favorites is the company's rich, aromatic (almost flowery) and mellow (AOC) Toscano cold-pressed olive oil which is normally available only seasonally, is still offered in San Francisco Bay Area Clubs at about \$9, less than half the comparable specialty food store price. if it can be found at all, that is. (Finding it elsewhere this coming season is very unlikely because Costco bought 60% of this past year's "classified" below-normal crop.)”** *Ed Weller, analyst, ThinkEquity, December 2003*

WORKING TO ACHIEVE TOP QUALITY

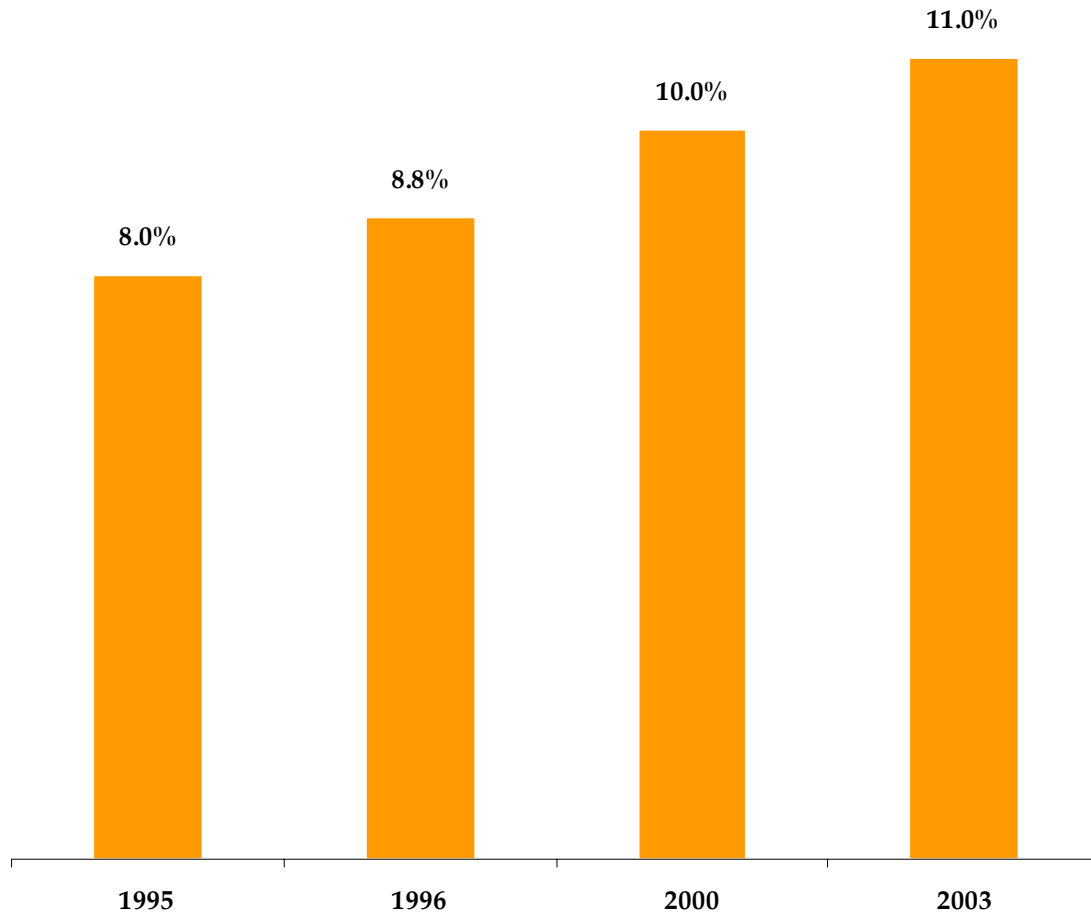
Costco uses the “tuna-story” to explain the value of a quality focus

- “This year we introduced our Kirkland Signature tuna. It sells for \$7.99 per eight-pack of six-ounce tuna cans. This is an exception to the rule as it’s a greater value due to significantly better quality, rather than selling at a lower price than the brand name. What we did was go out and get the best quality tuna that we could, and it was better than anything that we could find on any brand product out there. Our introduction of this product was with the intention of building a better product than was available in the brands and so far it’s been successful. We would expect that this product this year generate in excess of \$15 million of sales.” *Jim Sinegal, CEO, Costco, May 2003*
- “Kirkland Signature Canned Albacore Tuna is the perfect example of Costco’s quality- and value-focused mission. [We were] dissatisfied with the consistently declining quality of canned tuna in the national brands, [and] confronted the national brand leaders – Bumble Bee, Starkist and Chicken of the Sea. They all agreed that the [tuna products available] weren’t the best. One of them agreed to work with us to create a better albacore tuna – it was Bumble Bee. We created a private label tuna that was more expensive than the national brands, but that was OK with us... The partnership between Costco and Bumble Bee resulted in canned tuna product that had more fish, less water and better quality thanks to the focus on fillet-cut tuna. And it also resulted in Bumble Bee launching a premium-tier tuna under their own brand, using the Costco-defined specs.” *Tim Rose, SVP food, sundries and fresh products, Costco, April 2004*

GROWTH OF PRIVATE LABEL

Private label has grown to 11% of sales

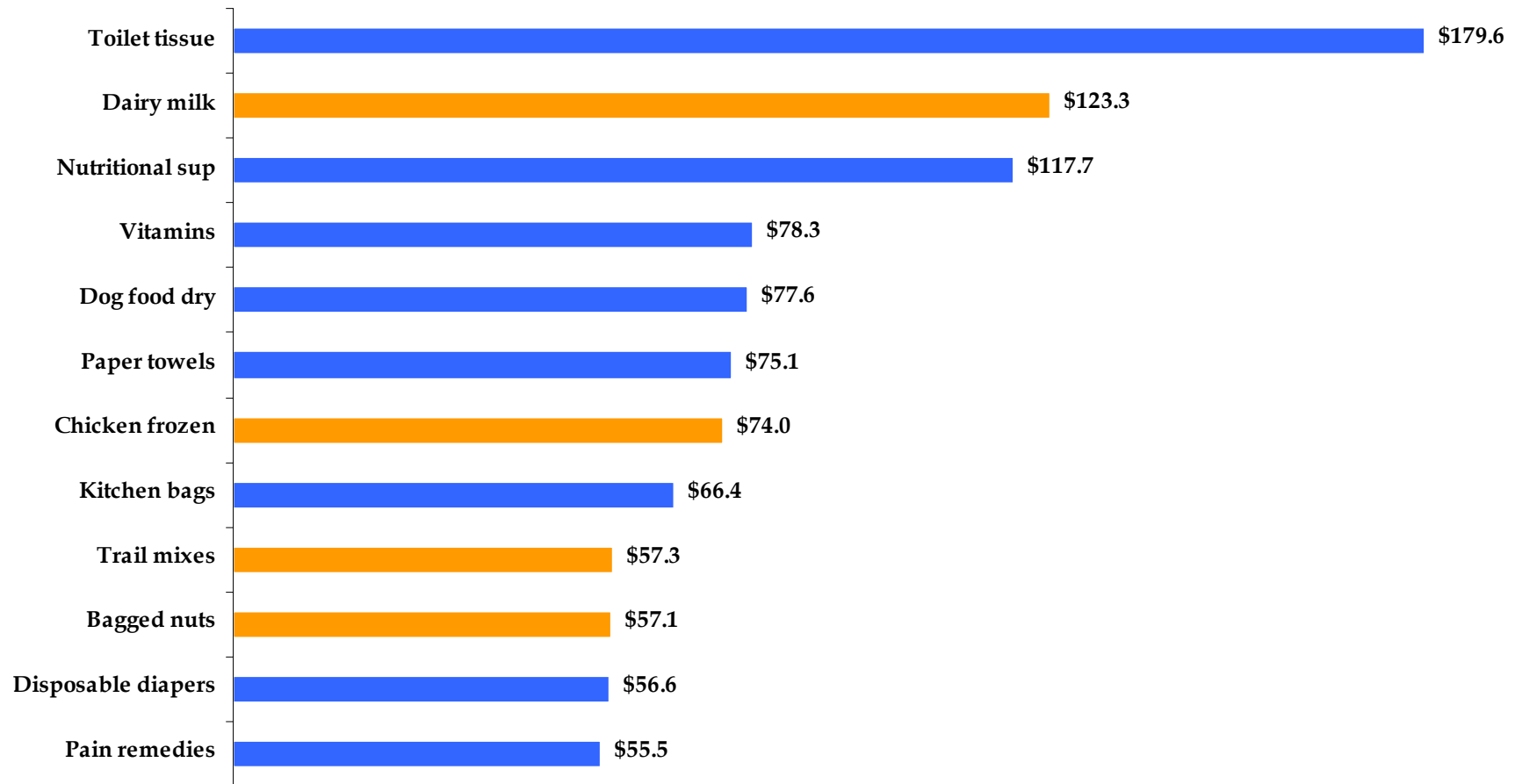
Private label share of sales
% of sales, 1995-2003



TOP TWELVE PRIVATE LABEL CATEGORIES

Unlike in supermarkets, private label sales in club stores are dominated by paper products and other non-foods lines

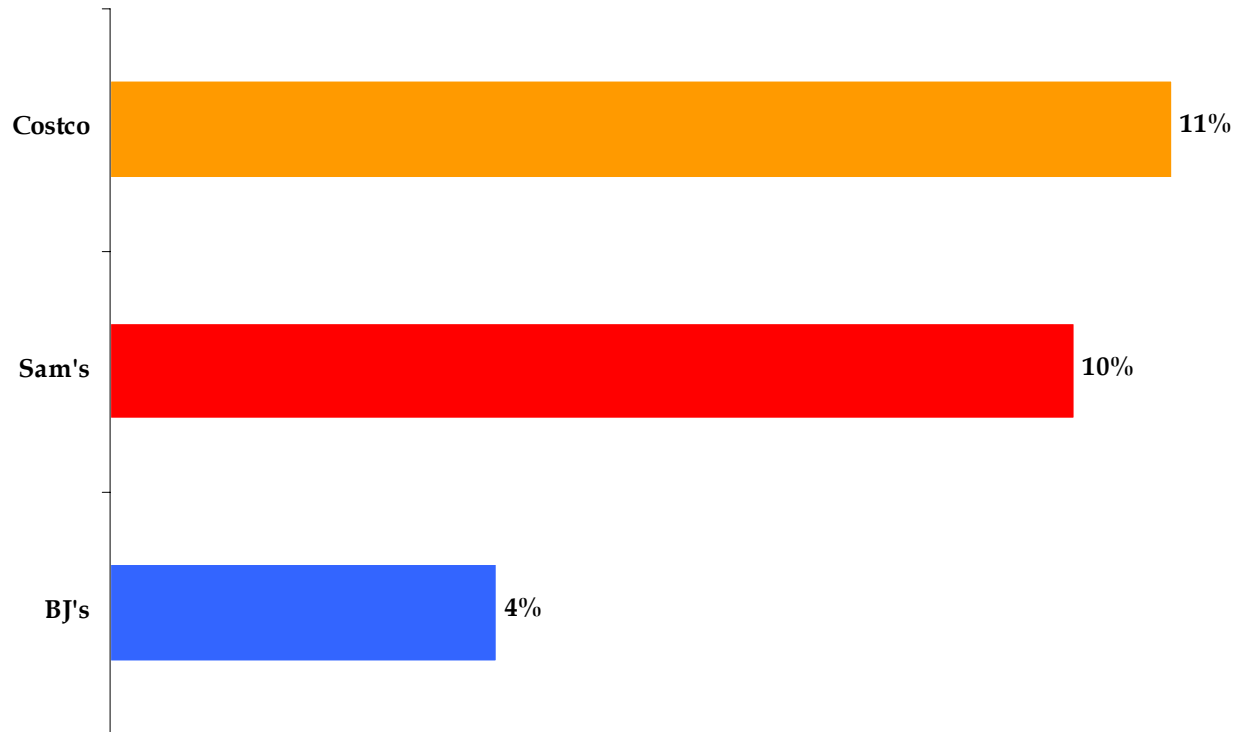
Top 12 private label categories in wholesale clubs by total sales in the United States
US\$, millions, 2002



PRIVATE LABEL SHARE BY GROUP

Costco has a higher private label penetration than either of its main competitors

Private label as a percent of sales
%, 2002



EXAMPLE OF PRIVATE LABEL MERCHANDISING

Like all products, Kirkland Signature is merchandised from easy access, display-ready pallets



CO-BRANDING

Costco also co-brands its private label where required (e.g. large appliances)

- **“Costco has added as stronger value message to the private-label products by co-branding the merchandise with recognized vendors. For example, Kirkland sheer/stretch pantyhose (3 for \$8.99) are made by Hanes, which is clearly marked on the package. Similar Hanes items would sell for more than \$5 per pair. Additionally, we’ve seen Kirkland trail mix made with M&Ms rather than generic candy-coated chocolates, conveying familiarity to the consumer while promoting the private branded item. Other cobranded products include chicken breasts, with Tyson.”** *Barbara Miller, analyst, BTAB, Jan 1999*
- **“Perhaps the most noteworthy recent development in the private label department was the introduction of a cobranded Kirkland Signature product line of major household appliances with the Whirlpool Corporation. This co-branding arrangement has been extremely well received and represents another original concept developed by Costco management that can now be expanded to new product categories. Other 1999 successes in private label include co-branded chicken products with both Tyson and Foster Farms.”** *Jonathan Zigler, analyst, Deutsche Bank, May 2000*
- **“A new introduction within the past month is a Kirkland Signature Scotch-Brite Wet/Dry Mop product, similar to the nationally branded Swiffer. With strong consumer reaction early on, Costco already discontinued carrying the Swiffer product and only offers its own – co-branded with well-known and admired Scotch-Brite and heavily merchandised on endcaps. Costco offers the starter pack, as well as the wet cloths and dry cloths refills.”** *Private Label Buyer, April 2004*
- **“The Kirkland label is being co-branded with Hanes on a line of pantyhose.”** *Forbes, August 1997*

EXAMPLE OF CO-BRANDING

For example, the Kirkland Signature Wet/Dry Mop is co-branded with Scotch Brite (3M)



PRIVATE LABEL GROWTH

While Costco plans to slowly grow private label sales over time, it is still primarily focused on selling branded goods

- *“We’re still very much a branded company, we still place a huge value on brand merchandise... If you don’t have national brands, how can people determine if you’re a good value? If everything is private label, what do they price it against... Our goal is only about 20 percent of total sales for private label, and now we’re about 10 to 11 percent of sales. There’s no big hurry, we don’t have a mission to hurry... Nothing is marked up more than 14 percent. That’s been our discipline since day one. Private label isn’t any different.” Tim Rose, SVP food, sundries and fresh products, Costco, April 2004*

GROWTH OF PERISHABLES

While the club format did not originally include perishables, this category has been a big success

- **“The big thing about fresh foods is that it creates a discernible difference between us and our competitors, if it's done right.” *Richard Galanti, CFO, Costco, July 1997***
- **“Costco began testing fresh meat, produce, and bakery products in 1987 for the purpose of increasing traffic, which immediately proved so successful that the company actually expanded its prototype size the next year in order to accommodate these features going forward. Initially, the added labor and shrink expense associated with these products (largely due to spoilage) were an obstacle, but innovative packaging (ready-for-display boxes, vacuum seals, shrink-wrap) and rapid acceptance led to fast inventory turns and quickly mitigated this challenge.**

“By 1990, fresh foods contributed 8% of sales, and also drove more frequent member visits as the value of cross-sales became increasingly apparent. Building on the added frequency derived from sales of perishables, Costco began testing prepared foods and home meal replacement in 1996 by adding rotisserie chickens at the absolute highest quality of freshness, placing them in direct competition with supermarkets. The product selection has continued to expand with items such as fresh seafood (contributing more than \$200 million to sales in 2000) and fresh flowers (\$40 million-plus in sales) helping to deliver the promise of one-stop shopping as members have become increasingly accustomed to having these available at the club.” *Bear Stearns, January 2002*

PUMPKIN PIE MADNESS

“On the two to three days before Thanksgiving, pallet jacks are taking these pies by the pallet load out on the floor and before they can get them into position people have purchased the pies.”



“We like to show this photo because we get a kick out of it. These are our Thanksgiving pumpkin pies. On the two to three days before Thanksgiving, pallet jacks are taking these pies by the pallet load out on the floor and before they can get them into position people have purchased the pies, leaving empty pallets. We do a great business on this and it’s great quality. It’s a twelve-inch pumpkin pie for \$5.99. You can’t beat it.”

Jim Sinegal, CEO, Costco, May 2003

SUCCESS WITH HMR

Costco is one of the few retailers to have success with home meal replacement (HMR)

- "Rotisserie chicken have been a huge success for Costco and constitutes a growing area within fresh foods... Family is key with the chain's rotisserie chicken program, where an average club will sell between 1,500 to 2,000 chickens each week. Chickens are offered for only three hours after they are cooked, in keeping with the company's emphasis on fresh cooked food... Costco is now testing rotisserie ribs. Costco probably won't try rotisserie turkey because the birds take too long to cook and too few can fit in the oven at one time. The rib test will be expanded as the remodeling process continues." *Discount Store News, July 1997*
- "The 1-year-old meal solutions program, under the Kirkland Signature label, includes 30 items. The selection consists predominantly of entrees such as salmon filets, sliced turkey or beef, along with mashed potatoes and a vegetable. The program does not include side dishes such as those typically available at supermarkets. However, Costco does offer a variety of salads including shrimp and chicken caesar. The meals offer customers a choice of heat-and-serve or ready-to-cook entrees that are priced from \$7 to \$15 for family size." *Discount Store News, July 1997*

EXAMPLES OF HMR OFFER
Costco has a strong and appealing HMR offer



MERCHANDISING PHILOSOPHY

Costco's merchandising philosophy is summed up by Sol Price's original "Six Rights of Merchandising"

The Six Rights of Merchandising

- The Right Merchandise* High quality, brand name and private label merchandise augmented with key locally sourced products.
- The Right Time* Maximize technology throughout the distribution and sales process to maintain in-stock and avoid over-stock conditions.
- The Right Price* A purchasing strategy to assure low price through volume buying.
- The Right Place* Strategy, systems and standards for the placement of merchandise on the sales floor.
- The Right Quantity* Implement and use a just-in-time flow of product concept when ordering and purchasing to maintain on-hand merchandise.
- The Right Condition* Merchandise is pre-marked in the appropriate language and prepared for handling at the selling locations.

THE SIX RIGHTS IN PRACTICE

In practice, the “Six Rights” can be interpreted as follows:

Interpreting Costco’s Six Rights of Merchandising

The Right Merchandise	The Right Price	The Right Condition
<ul style="list-style-type: none"> - Top quality - Brand name - Great value - Image - Exciting - Competitive - Private label 	<ul style="list-style-type: none"> - Lowest shelf price in the market per unit basis - Will not sell below cost - Competitive shops - Low margin 	<ul style="list-style-type: none"> - Clean, undamaged, presentable display - Marked accurately, securely, legibly - Saleable
The Right Time	The Right Place	The Right Quantity
<ul style="list-style-type: none"> - New - Early in/early out - In before competition has it - Just in time 	<ul style="list-style-type: none"> - Where member can buy it - Categorization - End-cap vs. modular for inventory purposes 	<ul style="list-style-type: none"> - In-stock - Right amount for proper presentation - Avoid excess inventories

COSTCO SUPPLIER GUIDELINES

Manufacturers who would like to sell their products to Costco should know that Costco buyers work according to the following guidelines:

1. **Be creative in selecting products.**
2. **Purchase an item early in the item's life cycle and sell it before that cycle hits a peak.**
3. **Research and stock regional items.**
4. **Products should arrive at the clubs ready to be sold and warehouse employees should handle products as little as possible.**
5. **Follow strict margin requirements. Do not sell an item below cost or price an item above 15% margin.**
6. **Reflect all deals in the cost of goods and reduce the retail price.**
7. **Abide by an intelligent loss of sales. If a competitor is selling an item below cost, delete the item, replace the item or purchase the item from that competitor.**
8. **Be the first retailer to stock seasonal merchandise and be the first retailer to be out of stock on seasonal merchandise. This will reduce markdowns.**
9. **Constantly try to increase the quality of a product without adding to its cost structure.**

ITEM MANAGERS NOT CATEGORY MANAGERS

Costco buyers think of themselves as item managers, not category managers

- "We buy items, not categories. It makes us more efficient, and we're able to get the right items and max out on them. We don't have 'bad items,' we have 'good items' that are selling - ones that we have the space to merchandise properly and drive the sales." *Tim Rose, SVP food, sundries and fresh products, Costco, April 2004*
- The Costco format is a very limited sku environment
- The company is an everyday low price (EDLP) operator and a dead net cost merchandiser
- Need to continually reinforce the value the membership provides by offering significant savings on every individual item - this channel does not employ traditional category management techniques
- Every item in the club must stand on its own and hit its particular sales targets (measured in sales per SKU per building)
- Costco has the highest SKU productivity in the US, at about US\$25,400 per SKU per building per year.

Average sku velocity by different measures Model

	United States	per club	
Sales per sku	\$8,077,750	\$25,402	← Costco expects average annual sales per club of over \$25,000/sku
per week	\$155,435	\$488	
per day	\$22,192	\$70	

GOOD ITEMS

What is the criteria for a good item? Item selection is the core of Costco's merchandising strength

Good item checklist

Awareness

- Built-in demand
- Includes Store Ops approval!

Ability to show value

- Availability
- At market level

Consistency

Self-selling packaging

- Visual
- 3-sided orientation
- Size

Display ready

Shrink-guarded

Unique, differentiated

- Customized

Service

Timing

- Marketing support
- Innovation

Retail support

- Collection of data
- Demo
- Display

5 by 5 rule

- Member should be able to see what the product is within 5 feet and 5 seconds

LOOKING FOR PRODUCT IDEAS

Costco is always looking for new product ideas

- **“We have a lot more winners than losers. But from time to time, we get a ‘bad’ item. The way we look at it is if sometimes you don’t have failures, you’re obviously not taking chances. One of our strong points is that we’re creative and eager to try new and different things. That’s what’s enticing to our members, and gets them in here. We’re creating a treasure hunt atmosphere for them.”** *Bill Hanson, General Merchandising Manager, foods and sundries - Midwest region, Costco, April 2004*
- **“In looking for new items, we go to all the merchandise shows, discounters, supermarkets, all sorts of retailers, and we examine catalogues. In establishing a sales target for a prospective item, we look at the past performance of like items, or the sales history provided by the supplier. If vendors put together an item in a warehouse pack, we’ll buy it, not because another club has placed an order for it, but because we think it’s good and fits into our format.”** *Jim Sinegal, CEO, Costco, November 1988*
- **“Paint was not a good classification for us... However, we're always looking at new classifications to test. TV satellite dishes, for example, recently were put in and we expect it to be an exciting item even if it involves one SKU. We've also added a spa, which could develop well. Home goods are an important sector for us. We do a nice business with seasonal patio furniture, KD furniture, for example, as well as domestics and traffic appliances and we're seeing fine growth in our major appliance business.”** *Jeffrey Brotman, Chairman, Costco, September 1985*
- **“We determine merchandise mix by retaining a basic stock and then we also test new units. We go to all the major trade shows to find new items and we go light in the testing but if they turn out to be good movers, we jump on them. We have approximately 3,500 active SKUs with 500 being discontinued for a total of 4,000. Almost all buying is opportunistic.”** *Jeffrey Brotman, Chairman, Costco, September 1985*
- **“If there’s no history, and it’s unlike anything we’ve done before, we’ll work with our vendors and put product in a few buildings to see how it does. We don’t want to put the burden on both of us and take such a chance. It’s a partnership, and as we build relationships with vendors, they’re very glad to try new items with us.”** *Bonnie Busch, general merchandising manager for non-foods, April 2004*

ROADSHOWS

One of Costco's key merchandising programs are its "roadshows," a larger version of an in-store demo, which are used to create excitement in an otherwise drab environment

- "Fresh seafood, for example, attracts bigger crowds than usual when the store hosts one of the company's seafood road shows. While seafood is usually offered daily, the road show brings in such specialty items as king crab legs, colossal-size shrimp and certain seasonal fish, among other products, at great prices. When Costco opened in Clackamas, Ore., this spring, the club offered whole king salmon for \$1.99 per pound and super-size shrimp for \$10.99 per pound. These road shows typically run for three days, over a long weekend, grand opening, holiday or special event." *Discount Store News, July 1997*

EXAMPLE OF A ROADSHOW

Ensure roadshows are part of your promotional plan when presenting to Costco



SUPPLIER RELATIONS

Costco has a reputation as a hard bargainer but willing to work with suppliers to reduce cost

- **“The company does not squeeze profits and customers' savings at the expense of its suppliers. Costco goes to great lengths to help vendors lower prices through improved logistics, better ordering services and often helps to sharpen vendor's production processes. An example of this is that Costco buyers will actually make the effort to visit suppliers and work out where the company can make changes which enable them to break even or make a profit without raising prices. Costco can also feel safe in the knowledge that it knows the business people it is dealing with.” *Commerce Business, April 1998***
- **“Costco doesn't squeeze all of its profits (and its customers' savings) out of the hides of its vendors. It goes to extraordinary pains to help vendors lower prices through improved logistics, better ordering and sometimes a sharpened production process. John Johnson, a Gillette sales official, raves about how Costco veteran buyers visit his manufacturing sites and corporate offices, learning about production and distribution. "That gives them a leg up on the competition in knowing who they are doing business with," he says. Tyson Foods' sales executive Greg Huett recalls when Tyson told Costco's buyers it had to raise prices to cover rising costs. "They sat down with us in our Georgia plant, and helped us figure out process changes where we could break even or make money without a price increase.” *Forbes August 1997***
- **“Costco used to sell fresh salmon fillets much like what you'd get at the neighborhood grocery store: with skin, belly fat and some bones still to contend with. Price: \$5.99 a pound. Over a few years it pressed its suppliers to trim the fat, peel the skin and ditch the bones. The price, meanwhile, was driven down to \$4.99 a pound. Customers bought more, giving Costco the heft to purchase directly from suppliers in Canada and Chile and shave the price further to \$4.79, barely half what local fishmongers charge. Costco now sells about 9 million pounds of salmon fillets a year, including the Salmon Milano that is its most popular, ready-to-cook dish. That's what the company might call "engineering" better values in its clubs by getting involved in production and distribution of a supplier's wares. Learning the sliced-ham trade has helped keep prices stable in a volatile item. Locking in favorable prices for butter and tin, as well as managing currency exchange and increasing package size, landed shoppers a better deal on imported butter cookies that are packaged in tin boxes.” *Forbes, August 1997***

SUGGESTIONS FOR IMPROVEMENT

Suppliers should expect to work with Costco to improve products

- “On a recent morning, Jeffrey Meek and several colleagues were busily assembling a collection of outdoor furniture they were hoping Costco would agree to carry. Meek had flown in from Rhode Island, where he is president of Rustic Natural Cedar Furniture. A sale could mean keeping his manufacturing plant running year around. “We’ve never done this kind of big-customer sale,” Meek said of the hour-and-10-minute presentation to Costco buyer Deanne Witt. No question was too small. Witt wanted to know if Meek’s company could package its swing set in one box instead of two. She wanted to know how quality differed between his product and a competitor’s. She asked if the company could make its bench more curved for leg comfort.” *Seattle Times, July 1997*

PAST STRUGGLES FOR SUPPLY

Costco has struggled in the past with manufacturers to get supply...

- **“Some manufacturers have refrained from selling to the Price Club, because we prices items at below suggested list, but as we get bigger, more of them are dealing with us, just as more of them are dealing with the off-price soft goods people.”** *Sol Price, Founder, Price Club, May 1983*
- **“Because Costco does such large volume and has such good demographics, it's gone from being shunned by prestigious consumer-goods makers to being wooed by them. At first Titleist, Cuisinart, and Levi's wouldn't sell to Costco because they didn't want to displease their full-price retail customers or degrade their products in the discount channel. Things have changed dramatically in the past couple of years.”** *Fortune, November 2003*
- **“When General Mills' supermarket retailers complained about conventionally sized cereal products being sold in warehouse clubs, General Mills cut off that channel. Along with Costco, General Mills developed a large cereal box that's available to supermarkets, but because of its size most of them don't want to commit enough shelf space to carry it... We've had success with larger size items offering us a higher price point. We keep our costs low because we do very little handling of such product. It's forklifted to the shelf, the shrink top is removed and it's sold out of cartons.”** *Richard Galanti, CFO, Costco, May 1990*
- **“It is the policy of the Company to sell at lower than manufacturers’ suggested retail prices. Some manufacturers attempt to maintain the resale price of their products by refusing to sell to the Company or other purchasers that do not adhere to suggested retail prices. To date, the Company does not believe that it has been significantly affected by its inability to purchase directly from such manufacturers.”** *Price Club 10K 1989*
- **“[The manager of a shoe manufacturer] said I was disturbing his distribution [by diverting]. I pointed out to him that Costco accounted for half his sales. Nobody was really selling his product. They were just diverting it to us.”** *Jeffrey Brotman, Chairman, Costco, July 1997*

PAST STRUGGLES FOR SUPPLY

... and sourced through diverters or grey market suppliers

- "There's a tendency always in people to want to combine and restrict free and open competition. Life is easier that way. There's safety in the herd." *Sol Price, founder, Price Club, November 1990*
- "Detractors, however, say Costco and other warehouse clubs like it use an elaborate network of middlemen to get hold of department store-type merchandise that manufacturers and the full-price retailers don't want sold in a downscale warehouse. Some manufacturers have accused Costco of conspiring with foreign middlemen to divert expensive bicycles, jeans and other goods meant to open up new overseas markets in places such as Russia and Poland, into Costco warehouses, a claim the company labels as ludicrous." *Seattle Times, July 1997*
- "Why is it that sometimes these goods go offshore at half the price that they are sold in the United States? We're not entitled to get these goods? The American consumer is not entitled to that stuff?" *Jim Sinegal, CEO, Costco, July 1997*
- "Costco has been sued for everything from alleged interference with contracts between manufacturers and their dealers to selling counterfeit goods... Calvin Klein twice sued Costco... for allegedly selling poorly made Calvin Klein jeans and counterfeit Calvin Klein t-shirts... Costco representatives went around to the country's top department stores and found the same jeans made in Mexico that Calvin Klein had said were not intended for sale in the U.S. and the same t-shirts that Calvin Klein asserted were counterfeit... Legal action against Costco halted." *Seattle Times, July 1997*
- "We never do anything illegal. Period. End of story." *Jeffrey Brotman, Chairman, Costco, July 1997*
- "National branded merchandise is critical to the viability of Costco. But we can obtain almost anything we want, with the exception of some designer fashion items in clothing which really isn't our business. However, as an example, we sell Waterford crystal obtained from transshippers and the gray market, but items such as that represent perhaps a half of a percent of our volume. The balance is purchased directly. We don't buy our major appliances or TVs through distributors because we couldn't be competitive with big specialty chains who also buy direct. We don't buy for the carriage trade, but we do focus on the best level of any product. We'll buy the best item, for example, in GE TV. That means a customer who has \$400 to spend on a TV will be able to pay that amount but for the best quality that GE has to offer, instead of good." *Jeffrey Brotman, Chairman, Costco, September 1985*

RANGE OF ANCILLARY BUSINESSES ATTACHED TO UNITS

Costco's ancillary businesses offer a wide range of in-store services to customers

Description of Costco ancillary businesses

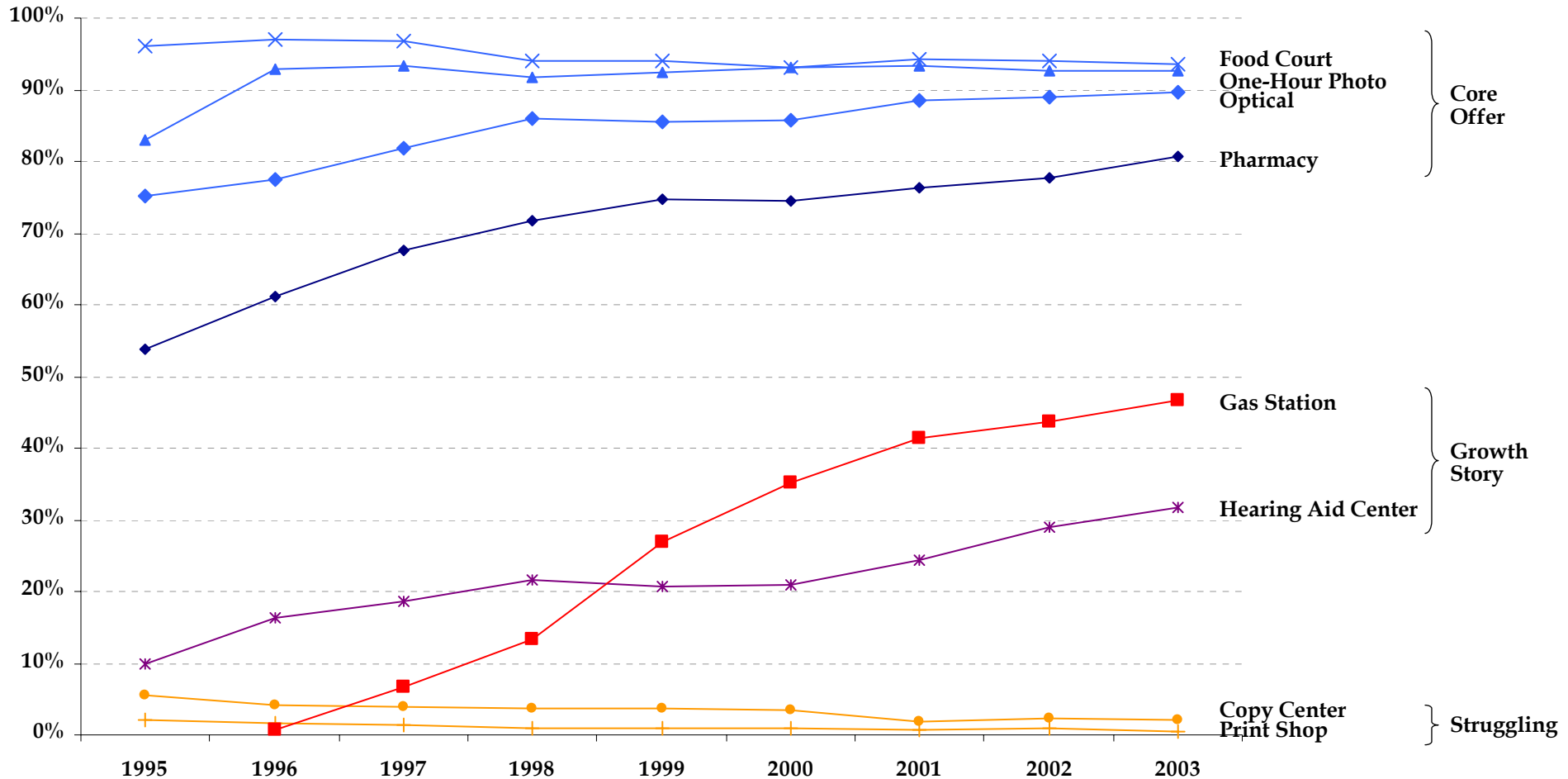
2003

Ancillary Business	Total Sales (\$m)	# of units with concept	Sales per store/year (\$m)	Description
Pharmacy	\$1,757m	347	\$5.1m	Offer brand-name or generic prescription drugs as well as a wide variety of over-the-counter products. (Also available at costco.com) Fills 13 million prescriptions per year (720 per unit per week)
Gas Station	\$1,403m	201	\$7.0m	High-volume, self-serve gas stations are safe, clean facilities offering low prices, pay-at-the-pump convenience, high-speed pumping and extra-long, flexible hoses to make filling your tank quick and easy.
Food Court	\$324m	402	\$0.8m	Fresh pizza, hot dogs, frozen yogurt and cold soft drinks right at the warehouse. Many locations also offer specialty foods like churros, soft pretzels and more.
Optician	\$302m	386	\$0.8m	Optical Department with an Independent Doctor of Optometry. Featuring a wide variety of contacts and designer frames.
1-Hour Photo	\$163m	398	\$0.4m	State-of-the-art 1-Hour Photo processing labs feature high-quality processing of 35mm, Advanced Photo System film and digital media. Also offer passport photos, photo announcement and holiday cards, photos on CD, reprints and enlargements.
Hearing Aid Center	\$47m	136	n/a	Costco's Hearing Aid Centers offer traditional, programmable or 100-percent digital hearing aids, with on-site custom computerized programming.
Tire Centers		n/a	n/a	Professional staff install your tires while you shop. Featuring brand names like Michelin at low warehouse prices. One low price for installation and lifetime service.
Print & Copy Centers		11	n/a	Offers professional printing services, print finishing, custom promotional products, and color and black-and-white photocopies. It's your one stop print and copy shop!

UNITS WITH ANCILLARY BUSINESSES

Pharmacy, Gas Stations and Hearing Aid Centers have are the growth engines in terms of unit numbers

Percent of Costco units with select ancillary businesses
% of units, FY1995-FY2003



LINING UP FOR GAS

Costco has had customers lining up down the block to get gas

Customers lining up for gas at Costco's Issaquah, WA unit



SUCCESS WITH ANCILLARY BUSINESSES

Costco has had good success with its ancillary businesses

- **“We now fill over 13 million prescriptions a year. It is another signature department for us. If I were to pick two departments for which we get the most notoriety in the press, it would be our gas stations and our pharmacies. We continually get our name in the newspapers and in surveys because of the pricing that we have, on both generic and name brand drugs. The Wall Street Journal last week ran an article that showed the price of a specific generic drug with a high of 78 cents per tablet, to a low of 15 cents a tablet at Costco. We’ve also built a great reputation with our optical shops. We have been rated two years running as the number one chain operation in quality and value in optical shops. Our photo centers, the one-hour photo centers that we operate (with overnight film processing also available) and our food courts have become a very important part of our operation. We still sell a quarter-pound hot dog (an all beef dog) and 20 ounce Coke for \$1.50 – just like you can get it at the ballpark.” *Jim Sinegal, CEO, Costco, May 2003***

- **“These are our gas lines. I understand we were in the news today on our gas. Someplace, I think out on the West Coast, they had the lowest price on gasoline and our price was over \$2.00. So that will tell you what’s happening with that business. This is typically what our lines look like right now on gasoline. They interviewed someone on television not so long ago and they asked him if he knew what he was going to pay for gas and he said he didn’t have a clue but it must be a great price, everybody’s in line!” *Jim Sinegal, CEO, Costco, May 2003***

MEMBER SERVICES

Costco also offers a range of other services to its members

Sample Costco brochures for services

Now, Executive Members have 3 simple ways to Save

9¢ per minute!
Plus a low \$1.95 monthly service charge per line
Residential Long Distance
Save on every long distance call 24 hours a day, seven days a week.

10 1/2¢ per minute!
No monthly service charge.
Business Long Distance
One flat rate with no minimum. No special equipment.

16¢ per minute!
No per call surcharge.
Calling Card Feature
The convenient way to save on long distance when you're on the road.

MORTGAGE PROGRAM

“We saved \$3,650 on our Mortgage costs!”
— Kelly Fagan
Bothell, WA

Merchant CREDIT CARD Processing Service

1.5% Plus 15¢ per transaction
1.89% Plus 25¢ per transaction

Auto & Home Insurance
Travelers Property Casualty
A Member of Travelers Group

SAVE OVER 20%* ON AVERAGE

GROWTH OF SERVICES

Services have been a growth platform for Costco

- **"We consider ourselves to have been the most innovative warehouse club operator throughout the history of the warehouse club industry. We were the first to do pharmacies, the first to do one-hour photo, the first to do gas stations, the first to do fresh foods, the first to do optical shops and the first to do hearing aid centers. So we've always been at the forefront of trying new things and finding out which things our members like. We must and will continue to do this."** *Richard Galanti, CFO, Costco, September 2001*
- **"The idea is to give members as much value as you can, not only to keep renewal rates high but to attract new members. It's also a very fertile area for creativity and the clubs are constantly branching out into new areas."** *Jonathan Ziegler, analyst, Deutsche Banc April 2002*
- **"As you tour a Costco club, notice that, with the lone exception of overnight photo processing, Costco runs the peripheral services itself. Bank branches aren't welcome; neither are dry cleaners or Starbucks." "Why not job out some services to specialists?" "We find that we're not very good partners. We generally think we can do the thing better, and also we think the other guy's prices are too high."** *Richard DiCerchio, Chief Operating Officer, August 1997*
- **"They have the potential to leverage the current 15 million membership platform way beyond what conventional retailing would suggest."** *Barry Rothberg, analyst, Furman Selz, April 2002*
- **"I'd be very nervous about getting into the Coldwell Banker-Allstate-Dean Witter trap, where services become more valuable than the vehicle that's bringing them to the customer [alluding to the failed Sears synergy of the 1980s]. What we're trying to do with the business is to make the product more appealing--and the product is the warehouse."** *Jim Sinegal, CEO, Costco, April 2002*

SMALL BUSINESS SERVICES

Costco now offers a wide range of external services to its small business customers

Costco services for small business customers
2004.04

Service	Partner	Notes
Payroll processing	Intuit Payroll Services	Pay only \$31.82 per payroll per year for a six employee business
Merchant credit card processing	Nova Information Systems	1.66% + 21c per swiped Visa and Mastercard
Web site hosting	Affinity Internet	\$14.95/mo + \$10 setup fee; 200GB transfer; 200 mailboxes
Business communication services	AccessLine	\$17.99/mo virtual receptionist and voice mail system
Small business loans and lines of credit	American Express	6% fixed rate; \$99 origination fee; up to \$100,000
Health insurance	Health Net, others ¹	Small business health insurance at affordable rates
Business long distance	MCI	Unlimited local and long distance calling for a fixed fee
Check printing	H.B.S.	Save up to 50% on standard bank cost
Prepaid overnight delivery	Airborne Express	Prepaid nationwide envelopes \$9.90 each
Logo merchandise	Logo Warehouse	Save 40% on logo branded products

HOUSEHOLD SERVICES

Costco also offers a wide range of external services to its household customers

Costco services for household customers
2004.04

Service	Partner	Notes
Auto sales	Affinity Development	Select dealerships offer no haggle low rates on new cars
Auto financing	Capital One Auto Finance	3.5% 36mo APR
Auto & home insurance	American Express	Save up to 20% on insurance
Roadside Assistance	Road America	\$29.99 per year
Home equity financing	Lending Tree	Home equity lines at as low as prime +0%
Real estate agent services	Lending Tree	Substantial rebate when you buy or sell a house
Mortgage services	Lending Tree	Save up to \$1,000 in fees
Financial planning	American Express	Low rates on financial planning services
Life insurance	American Life Insurance	Save up to 25%; premiums as low as \$9/mo
Online investing	ShareBuilder	\$4 per trade; no minimum; no inactivity fee
Money market account	Capital One	High fixed yields on money market accounts/term deposits
Travel	Costco Travel	Low rates on special package deals
Credit card	American Express	Earn up to 2% cash back on purchases

SECTION 5: THE FUTURE

The final section looks at opportunities for growth for Costco, including further international expansion



"The people on Wall Street are irrational most of the time. They travel in herds. Most of them wait until the stocks have gone up and then they jump on because they're afraid to miss the parade."

Sol Price, Founder, Price Club, May 1983

COSTCO'S SHARE PRICE

After a run following the merger, Costco's share price has languished

Costco share price since merger
1994-2004



COSTCO STARTS PAYING A DIVIDEND

Costco recently started paying a shareholder dividend for the first time

- **“Costco Wholesale, long criticized by Wall Street analysts for favoring customers and employees over investors, will start paying shareholders a dividend next month.”** *Seattle Times, April 2004*
- **“We think the initiation of a dividend is a clear positive and the company's first shareholder-friendly move in some time.”** *Shari Eberts, analyst, J.P. Morgan, April 2004*

THREE QUESTIONS FOR COSTCO

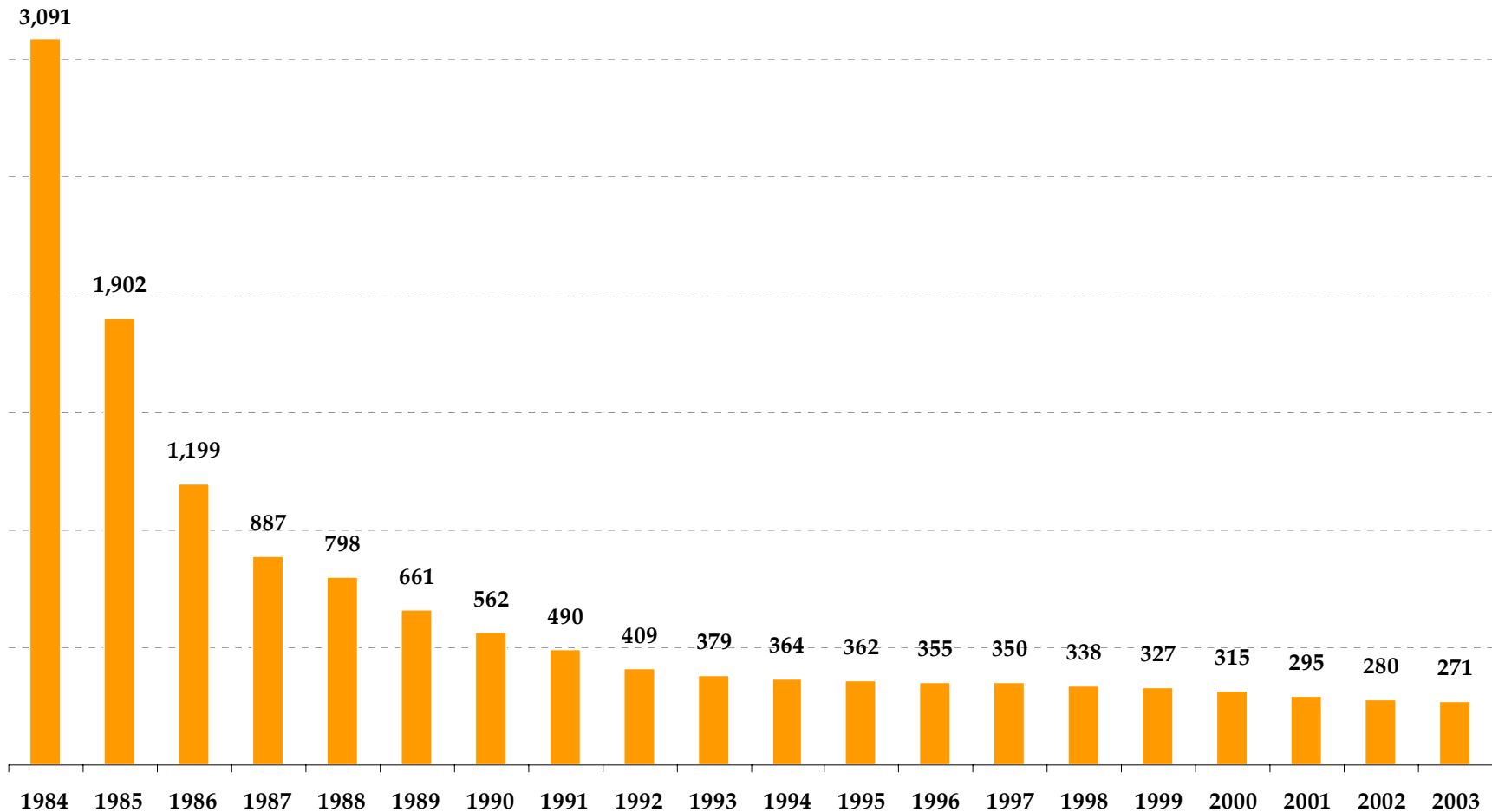
There are three questions facing Costco management:

- 1. Where is saturation?**
- 2. Can you increase your profits without compromising the concept?**
- 3. What next?**

QUESTION ONE: WHERE IS SATURATION?

At what density will the United States market become saturated with wholesale clubs?

Population per wholesale club in the United States
People, thousands, 1984-2002



SATURATION

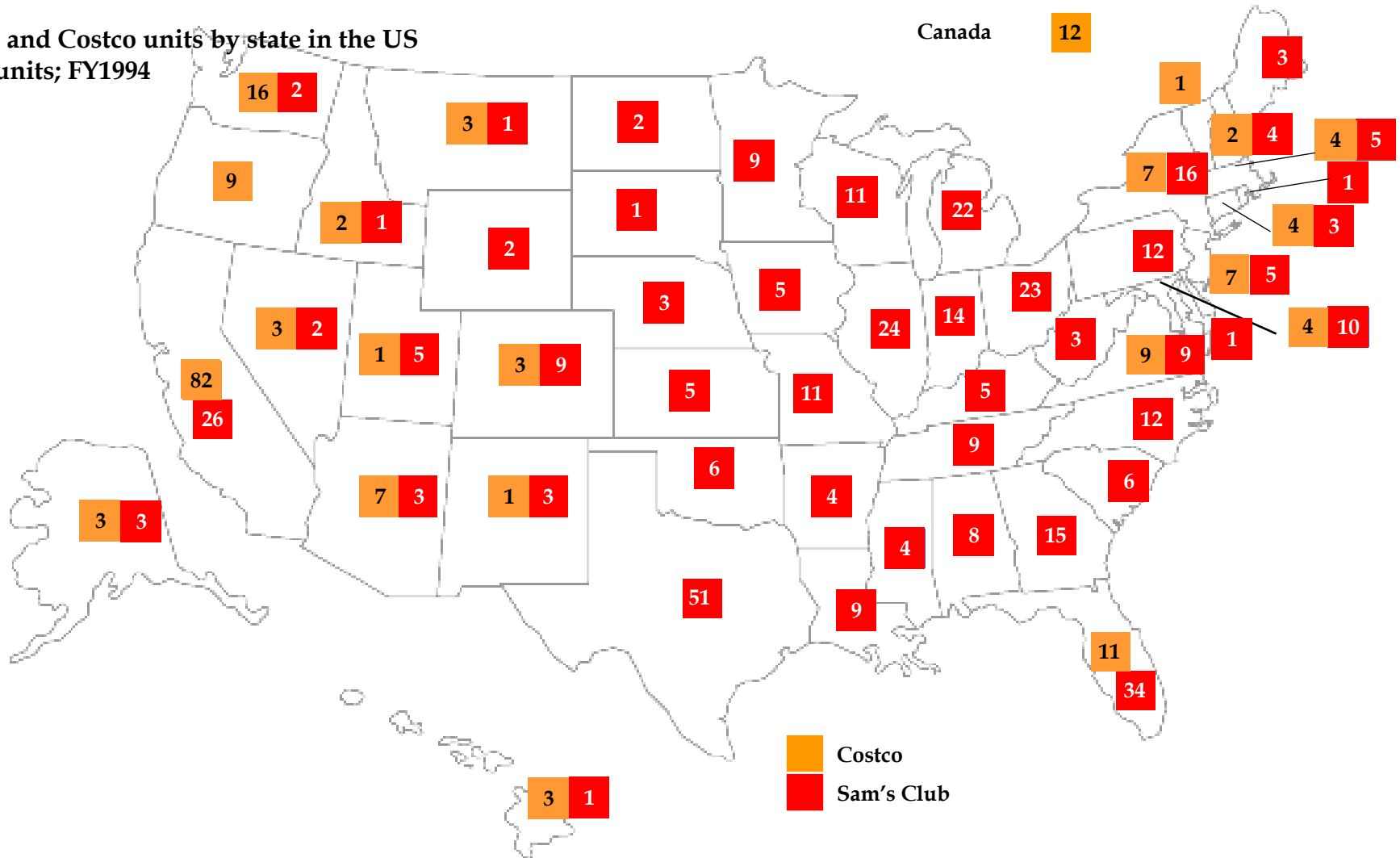
People have been predicting saturation almost as long as the industry has been around

- **"You're going to have several stores in every major U.S. city within five years if not sooner." *Daniel Barry, Analyst, Kidder Peabody, August 1985***
- **"Growth is projected to slow during the next five years as the membership warehouse industry hurtles toward maturity and as saturation of viably sized markets is reached." *Chain Store Age, August 1991***
- **"Although at present there are numerous expansion opportunities for clubs, within two or three years the prodigious pace of warehouse construction will decelerate. With that in mind, Costco management believes other vehicles might be required to maintain their momentum." *Stephen Mandel, Analyst, Goldman Sachs, August 1988***
- **"Wholesale club retailers take the most market share from wholesale distributors, not from other retailers. Tradition retail site location rules may not apply. Once the unknown saturation point is hit, the next step still is unclear." *Stacy Dutton, analyst, Morgan Stanley, February 1991***
- **"Domestic expansion will be curbed as the market reaches saturation this year or next... They will have to look abroad." *Euromonitor, March 1992***
- **"...as the clubs reach saturation level in the next two years." *Discount Store News, April 1993***
- **"The clubs' growth rate is slowing, he said, and the "Field of Dreams" philosophy (build it and they will come) is now obsolete. With the field nearly saturated, a decline in number of shoppers per unit is inevitable." *Wes Bray, consultant, Market Growth, April 1993***

COSTCO & SAM'S UNITS IN 1994

A number of commentators believed the market was saturated in 1994

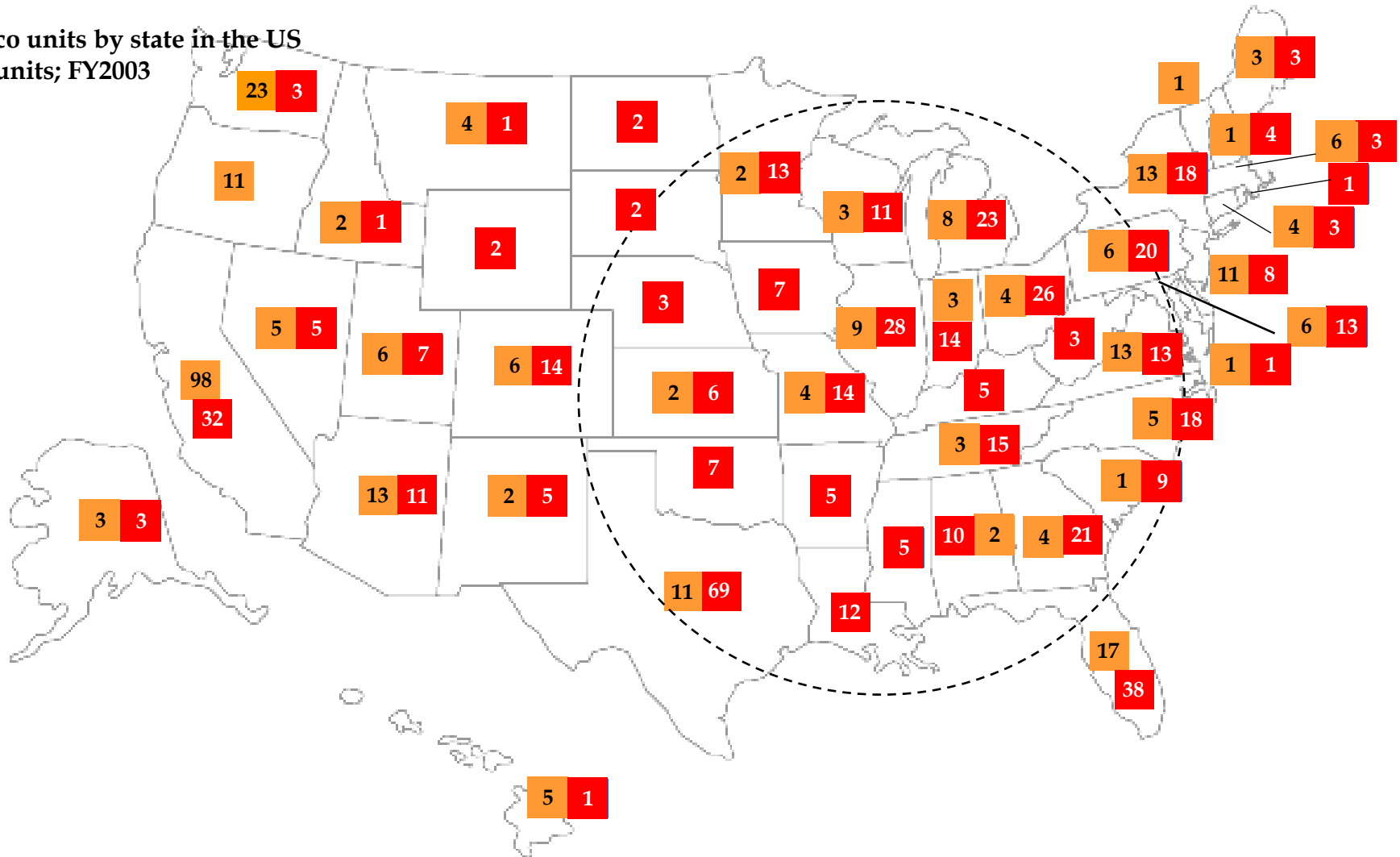
Price and Costco units by state in the US
of units; FY1994



COSTCO & SAM'S UNITS IN 2003

However, since then Costco has brought the fight to Sam's heartland of the Midwest and South

Costco units by state in the US
of units; FY2003



MANY MARKETS NOT YET SATURATED

While the company will at some point reach saturation, that point is still undefined - new Costco units in many existing markets only causes 20-25% cannibalization

- **“Obviously you're not worried about market saturation.” “Not at the moment. One thing we probably underestimated is market penetration. When we did our original business plan for the Puget Sound area, for example, we figured on four to five units; today we have 14 units doing over \$2 billion in business.” *Jim Sinegal, CEO, Costco, August 2002***
- **“A good example, in terms of the growth opportunities, however, is the Atlanta market. When we entered the Atlanta market it was a market that was dominated with seven Sam's Clubs for 10 or more years... Since that time, we've opened four Costcos in that market. So there's a market that has gone from seven to 11 warehouse clubs... Despite this, we are continuing to look at additional opportunities in the Atlanta market. But even with the existing 11 warehouse clubs, the seven Sam's and the four Costcos, the sales volume generated by warehouse clubs in that market has more than doubled in the last four years. We estimated that, prior to our entry into Atlanta, Sam's was doing, between all seven units, about \$450 million. We believe that the market now is doing close to \$1 billion.” *Richard Galanti, CFO, Costco, September 2001***
- **“What we have found is that every time we think that a local geographic market is saturated, we discover that we have the ability to put in another location. And while upwards of 15%-20% of a new location's sales in the first year might be cannibalized sales transferred from a nearby Costco location, fully 80% or 85% of the sales are new sales.” *Richard Galanti, CFO, Costco, September 2001***

QUESTION TWO: CAN YOU INCREASE YOUR PROFITS YET STAY TRUE THE CONCEPT?

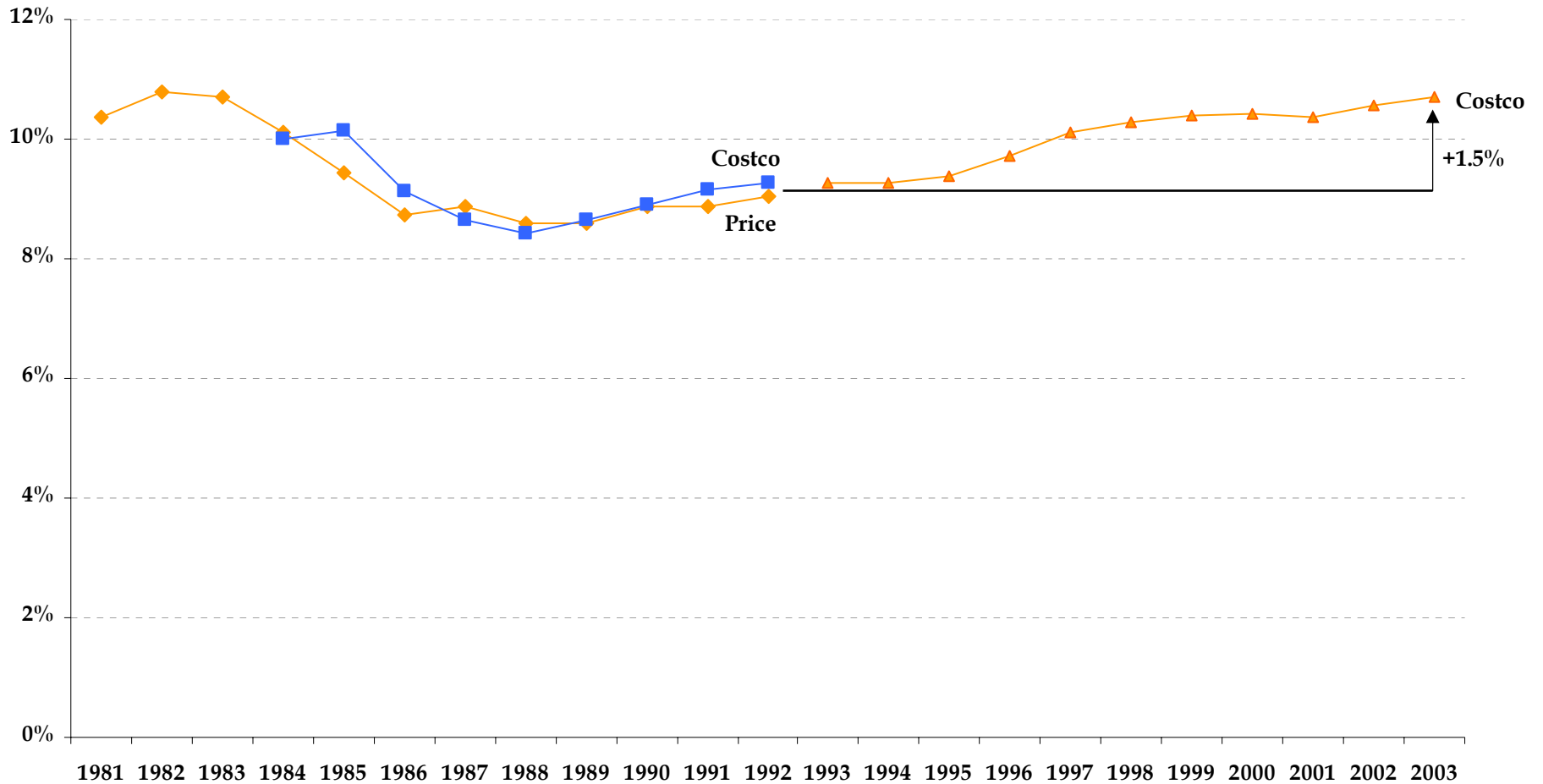
Costco is increasing its margins and increasing its costs

- **“What will happen to the industry in the future is what has happened in the past to every type of approach in distribution. The initiators start with simple operations, low cost facilities. They don't take credit cards or spend money on advertising. But as additional competitors enter the scene, each tries to give something better to the consumer - perhaps greater selection, credit cards and more expensive locations. As warehouse clubs build their sales it would be a fallacy to assume that they can lower their costs of doing business. I doubt that anyone can prove Sears' or any retailer's cost of doing business, is less today than it was when it was doing far less volume. That's certainly true of retailing, because it suffers from all the problems of bigness. So far that hasn't happened to us and, as far as I know, it hasn't happened to Wal-Mart yet, but it's inevitable, I believe, because the guys who started the business aren't there forever... Then along comes someone with a new distribution concept and beats them at their own game... The sweep of history is the sound of hobnailed boots walking up the stairs and the sound of the silk slippers walking down the stairs.¹” Sol Price, founder, Price Club, February 1989**
- **“We're mindful of the fact that the history of retail is filled with stories about people who started off like a Costco and eventually got fancier, raised their prices, and pretty soon there was no difference between them and their competition. Or their competition came in under them.” Jim Sinegal, CEO, Costco, August 2002**
- **“My hope is that Price will stay fresh and not leave much of an umbrella for a newcomer to step under and take the business. However, the nature of man and the reading of history don't offer much hope. People get old; organizations get old and someone comes in and knocks them off.” Sol Price, founder, Price Club, March 1989**

GROSS MARGIN

Gross margins have increased by 1.5% since the merger

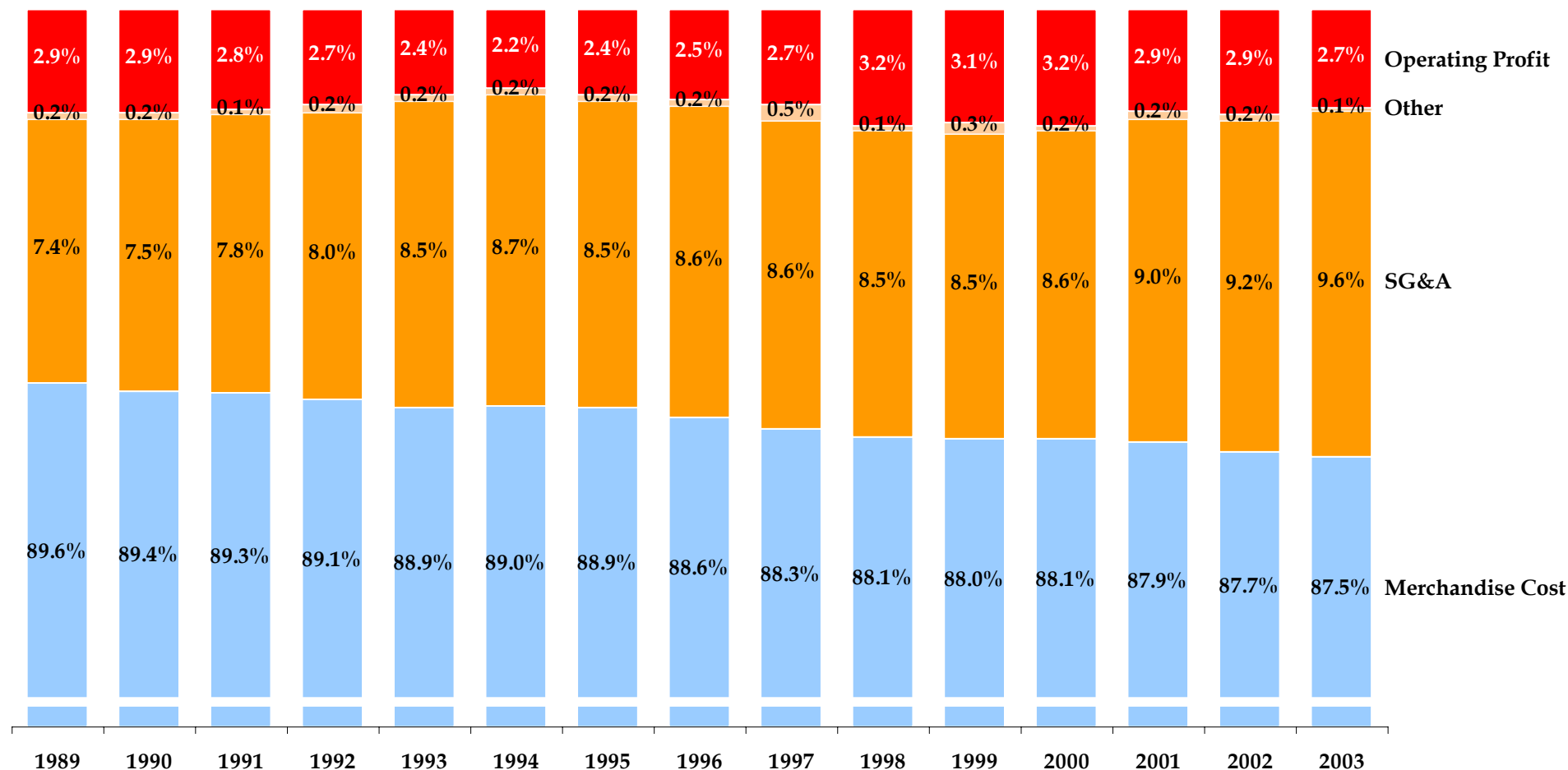
Raw gross margin percent for Price Club, Costco and merged company¹
 %, 1-(cogs/sales), FY1981-FY2003



COMPONENTS OF SALES

More troubling, as a percent of sales, selling, general and administrative (SG&A) expenses are growing while operating profit is not

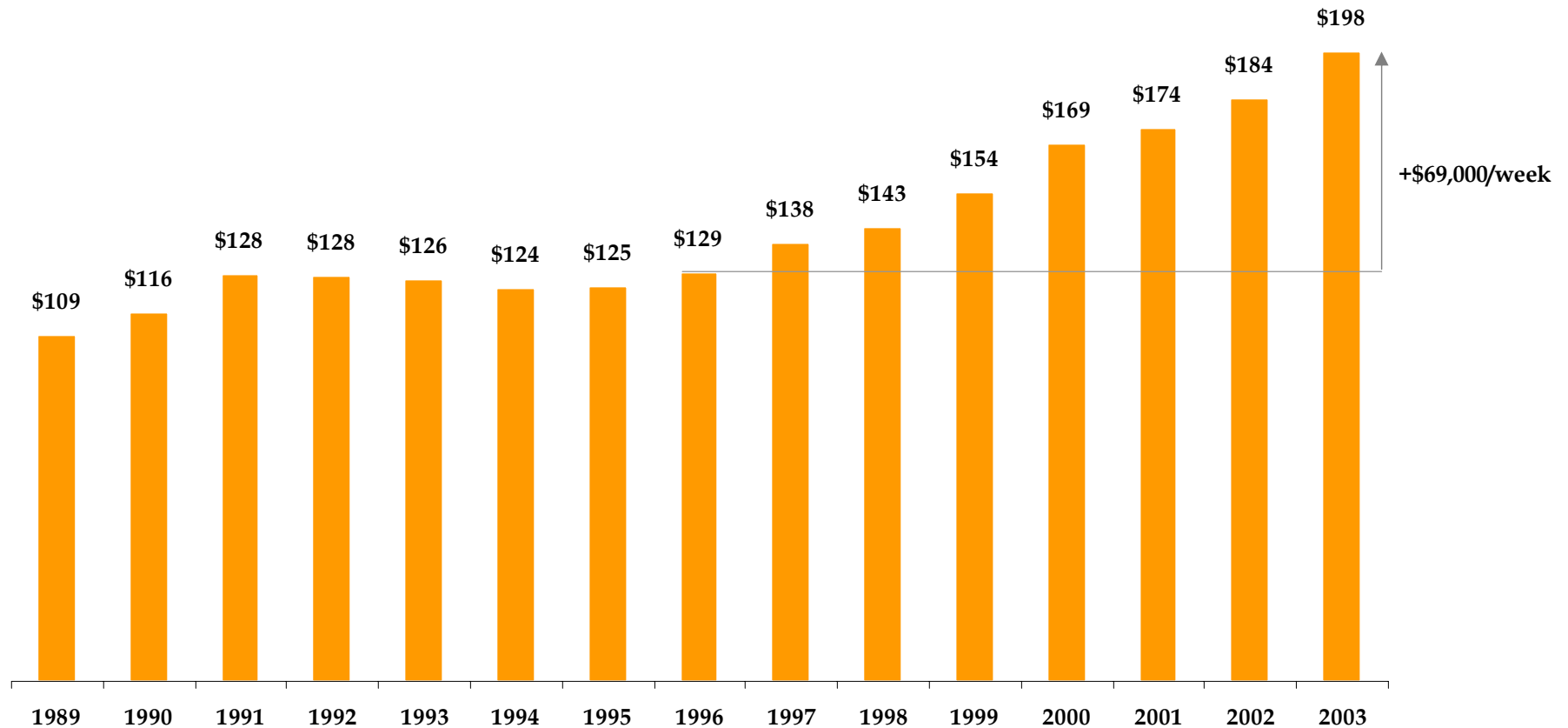
Components of sales over time¹
%, FY1989-FY2003



SG&A PER UNIT PER WEEK

SG&A has increased by \$69,000 per unit per week in the past seven years

Selling, general and administrative expense per unit per week
 \$, thousands, 1989-2002



SIX YEAR PLAN TO INCREASE MARGINS BY 1%

In addition, management has recently announced a six year, five point plan to increase pretax profits from 3% to 4%

- 1. Improving gross margins**
 - Better purchasing
 - Offering more upscale products
 - Growing private label
- 2. Growing sales per warehouse**
- 3. Becoming 100% supplier funded**
- 4. Employing creative cost cutting measures**
- 5. Increasing membership fee/value**

QUESTION THREE: WHAT NEXT?

Costco has four options for growth:

Potential growth paths for Costco
Model



1. INCREASE RANGE & ADD SERVICES

Opportunities to expand range are limited

- **“Can you think of any niche categories of merchandise that remain unexploited?” “For us, we certainly think higher-end electronics have the potential for greater exploitation in our business. Also, cosmetics, if we could ever find the key for doing that kind of business. Time will tell, but we think those are avenues of potential growth. We need to expand our fresh foods, and I am sure we will come up with some new wrinkles in that area.”** *Jim Sinegal, CEO, Costco, February 1999*

2. SMALLER STORES, SMALLER CATCHMENTS

Costco has trialed smaller stores in smaller catchments

Past Price/Costco new concept prototypes

Concept	Year Opened	Details	Outcome
Mini-Costco	1993	<ul style="list-style-type: none"> - 75,000sqft unit opened in Warrenton, OR (pop 2,500) - 150,000sqft unit opened in Idaho Falls, ID (pop 26,000) - No meat or bakery; regular assortment otherwise; - Probes the concept of a scaled back club for smaller markets; branching out because of saturation - "To see what we can learn about operating in these markets" - "We took something out of every department." JS, 5/98 	?

- "Costco will open its first mini-club, a unit of 75,000 square feet, in Warrenton, OR... Both Astoria, Ore., the major town near Warrenton, and Twin Falls have populations of roughly 35,000, no membership clubs and a number of established supermarkets... This is a very small trading area and we were unsure that it could support a full-scale club." Jeffrey Brotman, Chairman, Costco, May 1993

3. NEW CONCEPTS - FURNITURE

Price Club trialed a stand-alone furniture offer in 1989 which lasted a year and Costco is currently trialing a larger, revised 100,000 sqft Costco Home offer

Past Price/Costco new concept prototypes

Concept	Year Opened	Details	Outcome
Price Club Furniture	1989	<ul style="list-style-type: none"> - 48,000sqft stores - Opened two units in Southern California - Adjacent but separate from Club - Offering home and office furniture facilities - "High end furniture with low margin elements" - Warehouse interior, high open ceilings, cement floors 	Closed 1990 (?) Lower sales than expected
Costco Home	2002	<ul style="list-style-type: none"> - 100,000sqft; 13,000 lines - Drawing lessons from success of IKEA - 20 design employees on hand to assist - Showroom setting not warehouse - Projected sales from \$40-60 million - Draw from 20 mile radius - Profitable within first year of operation 	Opening second unit in Arizona

LESSONS FROM IKEA

Costco Home, with its display showroom and an attached warehouse, has clearly studied Ikea

Costco Home test store



GOOD SO FAR...

The Costco Home trial appears to be going well so far and is being expanded to a second store

- ***“We do furniture twice a year, going out of Christmas and going out of garden. We don't have room in our existing Costcos to do furniture on a year-round basis. In between seasons, it's very attractive to us... We're just going to open the second one [in Tempe, AZ] and see how it goes. The location suits us because we have such a big membership base in the general Phoenix market.” Jim Sinegal, CEO, Costco, March 2004***

3. NEW CONCEPTS – MORE GROCERY RANGE

Costco has also built a “food factory” and discussed two un-built store formats which move the warehouse club further in the direction of a supercenter

Past Price/Costco new concept prototypes

Concept	Year Opened	Details	Outcome
“Limited assortment hypermarket concept”	Planned 1989	<ul style="list-style-type: none"> – Proposed for Federal Way, WA – 155,000sqft; 15,000sku (vs. 4,000); 20% margins – Open to the public - no membership required – Leverage existing buying team – “Experimental GM and food store” 	Never built; opened as regular Costco instead
The Food Factory	2000	<ul style="list-style-type: none"> – 35,000sqft department added to one Seattle store – variety of scratch products produced on-site: roasting and packaging its own coffee beans, making beef jerky, potato chips, burritos, flour and corn tortillas, popcorn, orange juice and bottling water – All in plain view for the customers to see, smell and purchase - "great theater" – Sold under the Kirkland Signature brand 	Still in operation (?)
Costco Fresh	2002	<ul style="list-style-type: none"> – Concept for a 106,000sqft gourmet food store – Former Kmart site near headquarters in Bellevue, WA – Allows company to test various new gourmet food products before stocking them in stores – Focused on gourmet groceries, includes a pharmacy, olive bar, deli, café, garden center and photo and optical departments – Smaller pack sizes – Membership still required 	“shelved the idea”

3. NEW CONCEPTS – BUSINESS CENTER & SPORTS NATION

Costco has trialed a business center targeted at its business customer base and a Costco SportsNation targeting athletic consumers

Past Price/Costco new concept prototypes

Concept	Year Opened	Details	Outcome
Costco Business Center	1996	<ul style="list-style-type: none"> - 4,200sku + 10,000 additional order/delivery - Will deliver anything it sells for 3-5% of purchase price - Skewed heavily towards the foodservice industry <ul style="list-style-type: none"> - 55% food; 25% restaurant supplies; 5% custodial supplies; 15% all other business supplies - Print Shop; computers for rent - Conference room for rent - Also tested as a store-within-a-store in two locations (Newington, VA and Albuquerque, NM) 	Two remain in operation; launched online version
Costco SportsNation	1996	<ul style="list-style-type: none"> - Former Costco wholesale unit in Tualatin, Oregon - Converted into Costco SportsNation in 1996 - Indoor family sports center - "Part playground, part extreme sports testing ground, part retail outlet" - Year-round roller hockey, basketball and volleyball courts and Portland's highest indoor climbing wall - Included a restaurant and bar 	Sold to Leisure Sports who converted the site to ClubSport

3. NEW CONCEPTS – COSTCO.COM

Costco.com, launched in 1998, allows the company to offer a wider range of products to its membership and now has annual sales of \$250m (equal to two good units)

Screenshot from costco.com

COSTCO.COM

personal business rebates membership services warehouse locator customer service my account

search: product search go log in view cart check out order status sign up for special offers by e-mail: your email address go

new items & suggested buys appliances books & dvds computers & peripherals electronics & cameras furniture hardware & outdoor living health & wellness home & gifts jewelry & apparel office products pharmacy photo center services sports, recreation & tickets tires travel video games & software wine

hardware & outdoor living | spas & accessories

next product

The Luxury Backyard Spa Package

\$2,000 Off
Includes ProForm Spa, Gazebo & Sports Bar

the luxury backyard

Luxury Backyard \$2,000 Off \$11,999.99

add to cart 1 more info

proform magnum media spa

ProForm Magnum Media Spa \$4,799.99

add to cart 1 more info

proform outdoor sports bar

ProForm Outdoor Sports Bar \$4,799.99

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proform spa gazebo

ProForm Outdoor Spa Gazebo \$2,799.99

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Limited Online Offer:

Valid for orders placed May 1, 2004 through May 31, 2004.

Online price	11,999.99
*Less coupon	-\$2,000.00
YOUR COST	\$9,999.99

* The \$2,000.00 manufacturer's coupon will automatically be deducted at checkout.** No coupon number is needed.

3. NEW CONCEPTS - STICKING TO THE KNITTING

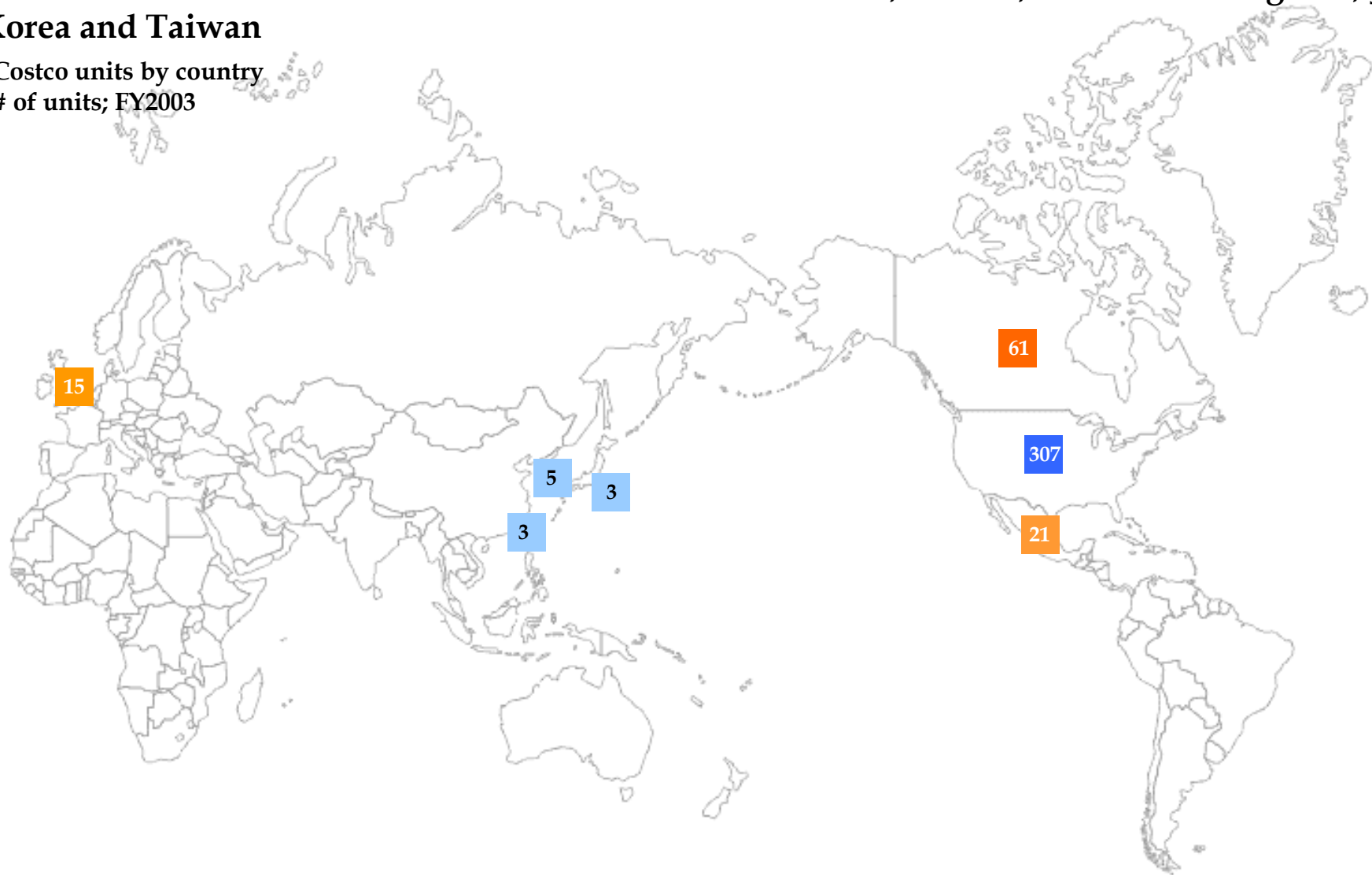
Costco recognizes that its core competency is operating membership clubs

- **"I think our focus is better placed on those items and not new concepts. We've just got more than enough things to concern ourselves with." *Jim Sinegal, CEO, Costco, February 2003***
- **"We're a firm believer in doing one thing very well. And that's opening up warehouse clubs." "So you're not going to venture off into some new realms?" "No, we'll continue to find new things within the warehouse club format." *Richard Galanti, CFO, Costco, September 2001***

4. NEW COUNTRIES - COSTCO GLOBAL UNITS BY COUNTRY

To date Costco has entered six additional countries: Canada, Mexico, the United Kingdom, Japan, Korea and Taiwan

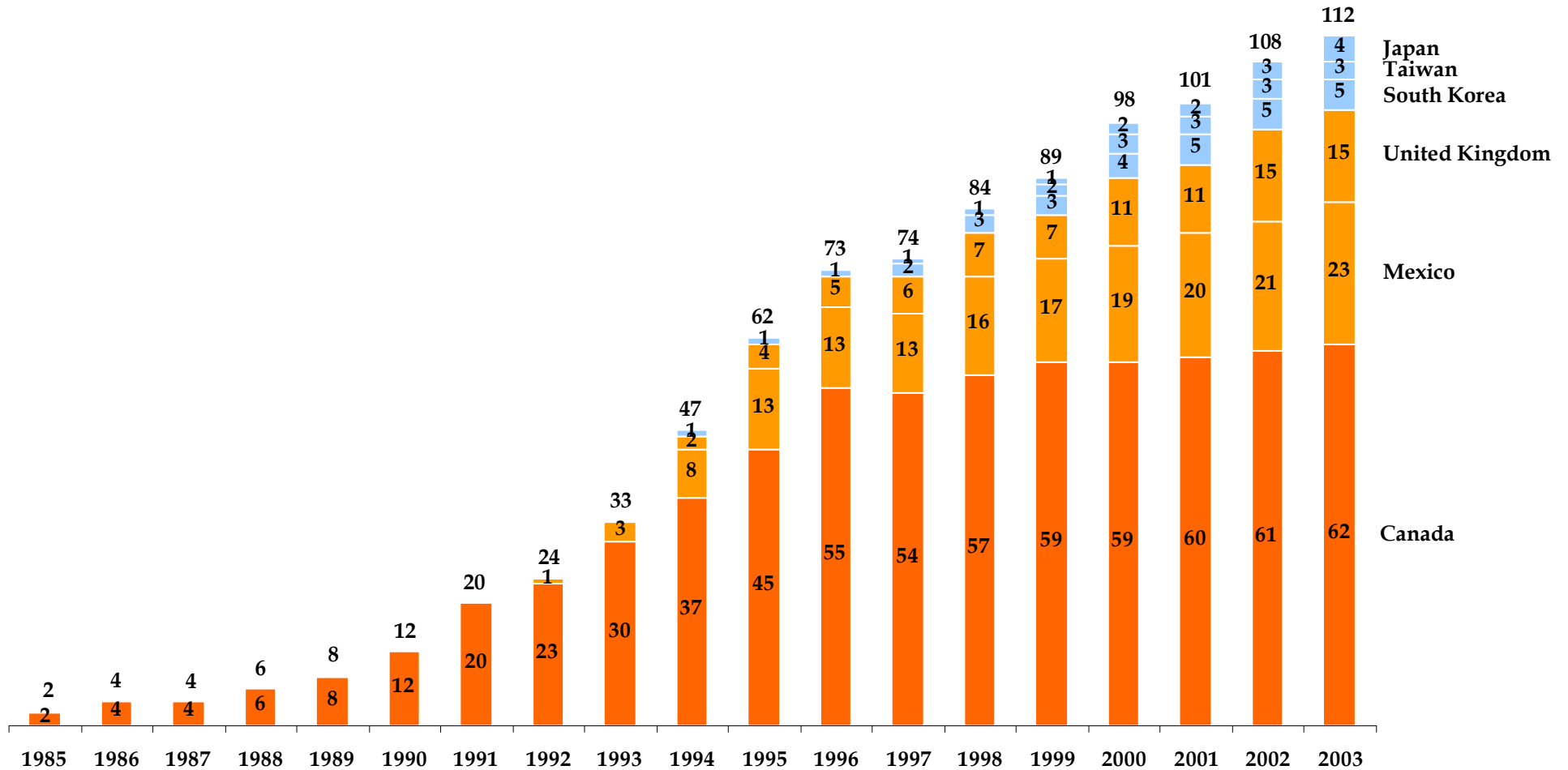
Costco units by country
of units; FY2003



4. NEW COUNTRIES - INTERNATIONAL GROWTH

Costco has shown consistent international growth over the past two decades

International Costco units by country
Units, actual, 1985-2003



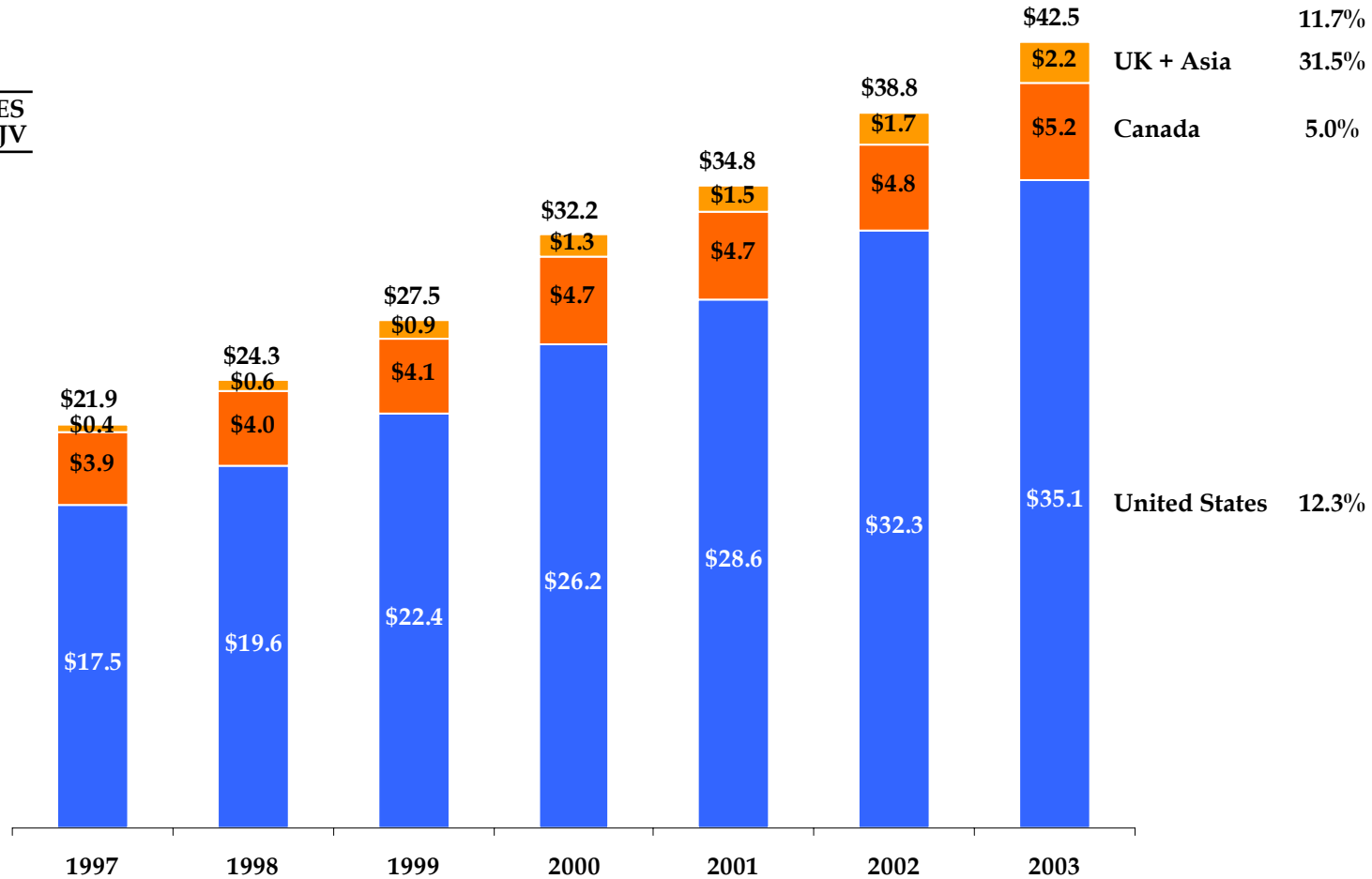
4. NEW COUNTRIES - INTERNATIONAL GROWTH

Costco has shown consistent international growth over the past two decades

Costco Sales by region
\$, billions, FY97-FY03

CAGR
97-03

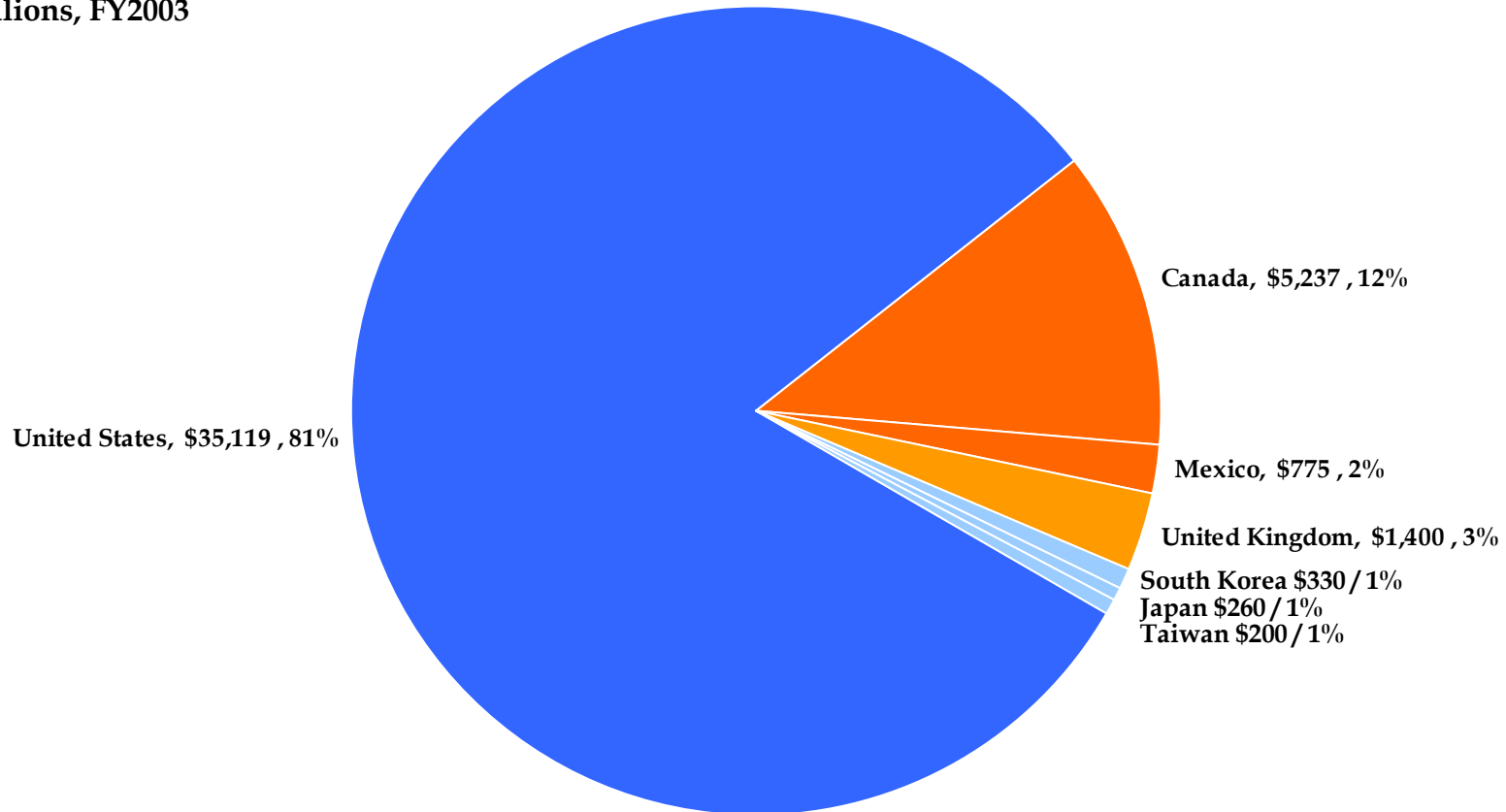
EXCLUDES
MEXICO JV



4. NEW COUNTRIES - SALES BY COUNTRY

However, the United States still accounts for eighty percent of Costco's turnover

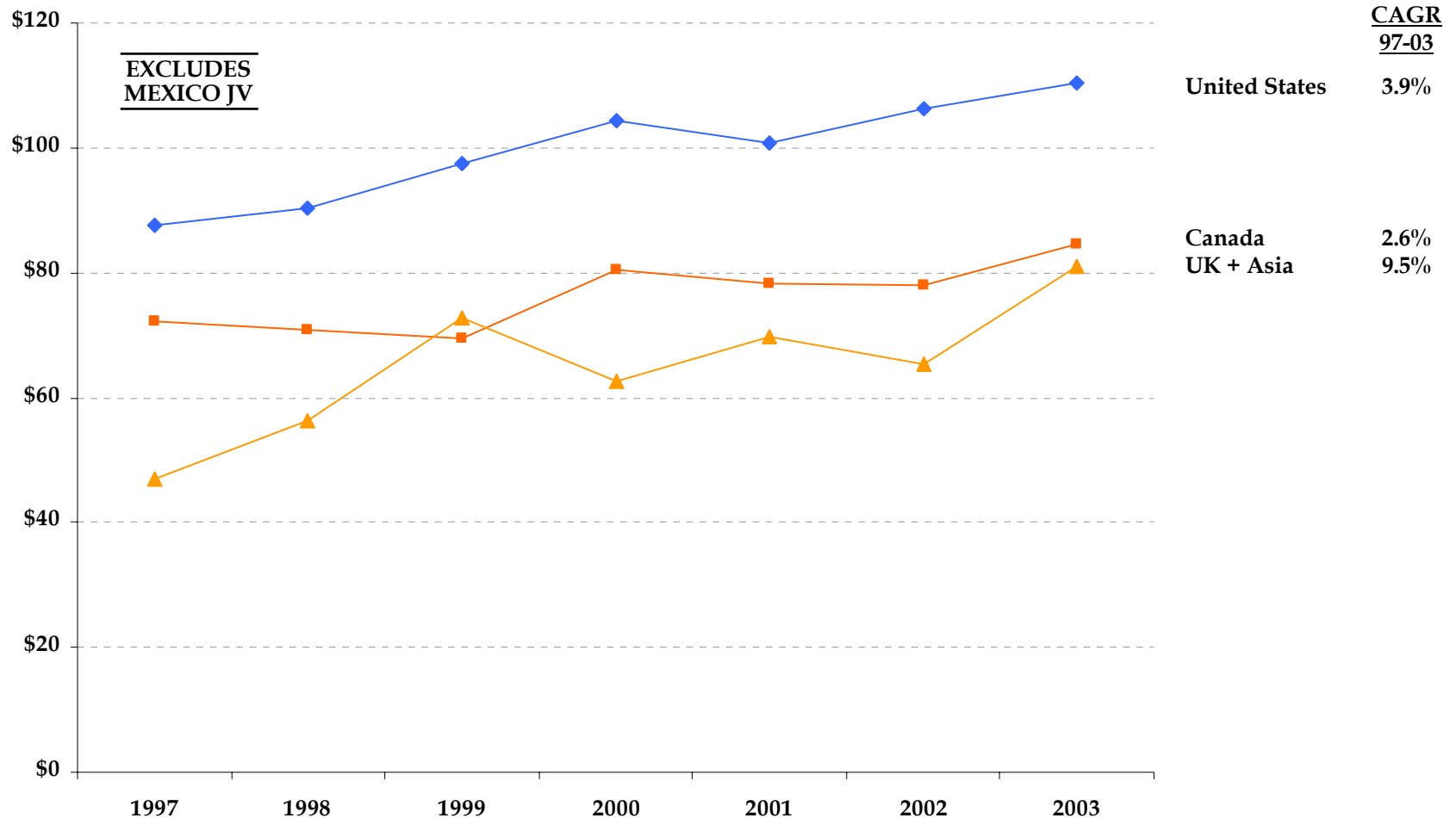
Costco international sales and structure
US\$, billions, FY2003



4. NEW COUNTRIES - SALES BY COUNTRY

On a sales per store basis, United States clubs still lead, Canada is second, but growing slowly, and the UK and Asia are showing strong growth

Costco sales per store per year by region
 US\$, millions, FY1997-FY2003



4. NEW COUNTRIES – ENTRY STRATEGY

In six of eight cases, Price/Costco has entered a new market with a joint-venture partner

Characteristics of Price/Costco International Ventures Various

Country	Year of Entry	Company	Entry Method	Price/Costco Ownership	Partner	Characteristics of Partner	Outcome
Canada	1985	Costco	Organic	100%	-	-	
Canada	1986	Price	Joint-Venture	50%	Steinberg Inc.	Major Canadian retailer operating 221 supermarkets and Miracle Mart department stores	Merged into Costco; partner bought-out
Mexico	1991	Price	Joint-Venture	50%	Controladora Commercial Mexicana	Major Mexican retailer	Still in place ¹
UK	1993	Price	Joint-Venture	80%	The Littlewoods Organisation plc	Privately owned UK variety store retailer	Merged into Carrefour venture
UK	1993	Costco	Joint-Venture	50%	Carrefour	Major international supermarket retailer with global operations	Costco bought out partners
South Korea	1994	Price/Costco	5 year license	94%	Shinsegae Dept. Stores	Major Korean retailer	Licensee acquired Costco owns 94%
Taiwan	1997	Costco	Joint-Venture	55%	President Dept. Store	Major department store retailer	Still in place
Japan	1998	Costco	Organic	100%	-	-	-

4. NEW COUNTRIES - GROWTH PLANS

Costco spelled out its medium-term international growth plans at an analyst presentation last December

Costco international unit growth plan
Units, December 2003

	Current	Future	Future
United States	319	600	+281
Canada	61	75	+14
U.K.	15	60	+45
Mexico	23	46	+23
Japan	4	50	+46
South Korea	5	15	+10
Taiwan	3	15	+12
International	111	260	+149
Total	430	860	+430

“Potential markets include Western Europe, Spain, Portugal, Italy, as well as Australia, New Zealand and Eastern Europe.”

4. NEW COUNTRIES – UK CASE STUDY: MARKET ENTRY

Just prior to the merger, both Price and Costco announced plans to enter the UK market, creating concern among existing retailers

- “A silent enemy poised for attack.” *The Financial Times, March 1992*
- “Price Costco envisions 50 clubs in the United Kingdom by the turn of the century.” *Discount Store News, Jan 1994*
- “These discount giants have been corroding average US retail prices over the past decade, bringing down consumer expectations to their cheaper levels and eating away at competitors' margins. Now they are secretly plotting to storm the UK with prices that will undercut any discounters already here. Their assault on the traditional supermarkets today could prove as momentous as the introduction of self-service stores in the 50s.” *Marketing, March 1992*
- “We targeted the United Kingdom because of a relative lack of development in the non-foods area and... cartel pricing here in food provide the company with a lot of opportunity in pricing, as well as in efficient operations... Wage rates are extraordinarily low compared to the very, very high profits structure, for example, in the supermarket business... We will try and keep our rent, if you will, or imputed rent, to 1% of sales. If we can keep our occupancy costs in that range ... and we can pay our employees double the going rate .. we can achieve the same productivity in terms of volume and other efficiencies [as in the U.S].” *Jeffrey Brotman, Chairman, Costco, June 1993*

4. NEW COUNTRIES – UK CASE STUDY: COURT BATTLES

Costco fought a number of court battles ultimately leading to the retailer being classed as retail not wholesale

- **“The three leading supermarket groups have been busy seeking a Court of Appeal ruling that Costco's planned warehouse club in Thurrock, Essex, should be classed as a retail rather than wholesale development.” *Supermarketing July 1993***
- **“I am convinced that warehouse clubs are neither wholesalers nor retailers. They are a hybrid and there is no research to say what class they should be in.” *Richard Hyman, Managing Director, Verdict Research, July 1993***
- **“The British government seemed to hit the wholesale club concept by ruling that these merchants are retailers, able to open stores only in retail-zoned locations. The companies planning clubs in the United Kingdom had hoped that the government would establish a new category for their stores that would allow them to open in either retail or wholesale-zoned sites. English supermarket chains had lobbied for the government's final ruling in the expectation that the higher land costs of retailing sites would slow down, if not stop, American companies from launching U.K. clubs. Costco's plan to open a club in Trafford Park near Manchester had been set back because of a zoning review by the national government's Department of the Environment.” *Discount Store News, August 1993***
- **“We experienced legislation difficulties in the past”, *Jim Sinegal, CEO, Costco, September 2001***

4. NEW COUNTRIES – UK CASE STUDY: PRESSURE ON MANUFACTURERS

While the major UK retailers pressured suppliers, Costco manages to secure supply

- **“The minute we start supplying any of the club warehouses, our retailer friends are going to say supply us for that price.”** *Unnamed Managing Director, a large food firm, November 1993 (quoted in Super Marketing)*
- **“We have received a high degree of co-operation from manufacturers and suppliers. They are forward looking, they are knowledgeable and they have educated themselves about what has happened in the US. They recognise the potential... Around 98% of supply agreements have now been signed.”** *Paul Moulton, Managing Director, Costco Europe, November 1993*
- **“A frantic round of negotiations across all consumer goods industries is coming to a head as Costco forges ahead with plans to open the UK's first warehouse club... A complex game of ducking, diving and dissembling between suppliers and retailers... According to rumours circulating in the trade, some branded manufacturers, under pressure from frightened retailers, have refused to deal with Costco. But most have signed deals claiming that Costco's terms are no better than anyone else's.”** *Supermarketing, November 1993*
- **“U.S. warehouse club Costco is sidestepping manufacturers which refuse supply by sourcing their brands from the ‘grey’ market... brands including Sony, Hitachi and Panasonic came through other distribution channels... Some rival retailers, including Dixons, are reported to have put pressure on their suppliers not to deal with Costco, which claims to undercut conventional supermarkets and store chains by up to 40%.”** *Marketing (UK), December 1993*

4. NEW COUNTRIES – UK CASE STUDY: CARGO CLUB LAUNCHED

Nurdin & Peacock, a 'troubled' British cash and carry chain, launched its own club format, which subsequently failed

- Nurdin & Peacock was 12% owned by Dutch Makro Cash & Carry, which set up in the US market in the early 1980's and later sold its joint venture to partner Kmart, who merged it into Pace Club
- "Nurdin & Peacock, the U.K. cash and carry operation that plans to launch its own Cargo Club membership warehouse chain, has picked retail-zoned sites for its initial stores in Wednesbury, a Birmingham suburb, and Croydon, a London suburb." *Discount Store News, August 1993*
- N&P appointed Mark Riches, a former Marks & Spencer executive, to head up its venture
- Concept "abandoned" and three sites sold to Sainsbury's in March 1995 for GBP45m
- "It could have worked. It should have worked. It certainly wasn't a failure. There was definitely room for a warehouse industry scaled down to suit the British market. The fact Costco's still here shows there is a niche... It took a long time to establish itself in the States. We just weren't given the time. N&P were very keen to move ahead at great speed and see a quick return. That meant spending an excessive amount on marketing, which the business couldn't justify. Essentially we were a shed operator with the lowest possible prices and we couldn't carry that kind of overhead. N&P lost heart when it didn't make money quickly enough for them. I was very sad when it ended. It was an exciting ride." *Mark Riches, ex-Director, Cargo Club, Nov 1997*

4. NEW COUNTRIES – UK CASE STUDY: RETAILER REACTION

UK retailers reacted in a number of ways to the arrival of Costco

- **“I’ve seen some of our competitors in here writing down prices, but that doesn’t worry me. Because that’s a battle we will win over time. They may be able to match us on one day, but not over time.”** *Jeffrey Brotman, Chairman, Costco, Dec 1993*
- **“Will prices come down overall because of us? I don’t think there is any question about that. Our mere presence has brought prices down before we’ve even opened.”** *Jim Sinegal, CEO, Costco, Dec 1993*
- **“British food retailers and consumers had wrongly imagined Costco as a low-priced version of traditional supermarkets... British have reacted by, in effect, picking up the marketing programs used by American food chains. The major English supermarkets have inaugurated everyday low price programs on an array of basic food products, launching what amounts to a price war. But the supermarkets have attempted to reduce the impact on their bottom line by applying the program mainly to private label goods, rather than national brands. To specifically counter Costco, they have added bulk goods sections to the supermarkets that directly compete with the club.”** *Discount Store News, January 1994*
- **“Asda is offering 100 of its best selling grocery lines in a cash and carry bulk buying format in nine of its stores. But it denies that the move is part of its defense against Costco.”** *Marketing (UK), December 1993*

4. NEW COUNTRIES – UK CASE STUDY: SALES SUCCESS

Sales at the Watford Costco unit exceeded £129m pounds in fiscal 2002, or almost £2.5m pounds per week

Costco store in Watford, UK before Christmas 2002



4. NEW COUNTRIES – UK CASE STUDY: STRUGGLE FOR SITES

Costco has struggled to find enough sites in the UK to support its 140,000 sqft boxes

- **"We're very profitable and we'd love to open plenty more in the UK. There it's an issue of zoning and getting the approvals."** *Richard Galanti, CFO, Costco, May 2003*
- **"US warehouse club Costco has opened three new depots at Chingford, Reading and Oldham this month, taking its UK portfolio to 14. However, progress this side of the Atlantic has been painfully slow, with planning headaches restricting growth to just a trickle of openings. Although Costco continues to scour the country for opportunities, no firm agreement has been reached on any further sites, it admitted. The current target is just four new clubs by the end of next year. Mintel analyst Richard Perks said the threat Costco appeared to represent in the UK market "never really materialised" as the company continues to be thwarted by the planning regime. When Costco arrived in the UK almost a decade ago, it predicted the market could "easily support up to 50 warehouse clubs."** *The Grocer, May 2002*
- **"We are looking virtually everywhere from Scotland to the south coast."** *Jim Murphy, Senior Vice President, European Operations, Costco, September 2001*
- **"We're never going to return to the climate of the 1980s, when development was rife, but more consideration needs to be given to the competitive trading environment, the redevelopment of brownfield sites, and jobs for the people who live there. Developing smaller outlets could solve the current problems of securing sites for sheds of up to 125,000 sq ft. But there were no plans to build them in the UK, even though Costco has been experimenting with 40,000 sq ft warehouses in the US. Smaller stores diminish the impact of the shopping experience for our customers."** *Jim Murphy, Senior Vice President, European Operations, Costco, September 1999*

4. NEW COUNTRIES - UK CASE STUDY: A LIMITED SUCCESS

Costco has been a success in the UK market, however growth is taking longer than expected

- **“One of Costco's Greater London warehouses is among the retailer's busiest in the world, according to president and chief executive Jim Sinegal. Sales at the Watford store exceed US\$200 million (GBP 129.4 million) a year, making it one of Costco's eight top-performing locations... putting Watford in the top 2 per cent.” *Retail Week, November 2002***
- **“In the UK Costco has been hampered by the planning regime but has opened 15 depots since it entered the market in 1993, and is still aiming for 45-50. With sales per depot around the £ 65- £ 70m mark, Costco UK is now a £ 1bn business.” *The Grocer, November 2002***
- **“Everything is chugging along just fine. It's a case of so far so good on this side of the pond. The UK business is solidly profitable, with strong like for like sales.” *Jim Murphy, Senior Vice President, European Operations, Costco, May 2001***
- **“And this year you're opening four more stores in the United Kingdom. How does the Costco formula translate internationally?” “So far, very well. One of the things that has helped us is that we found a certain mix of U.S. goods has made our places popular.” “Like what?” “Like vitamins. Like cranberry juice. Who'd have guessed that cranberry juice would be popular in the U.K.? But they don't get it over there. Olive oil, an Italian product marketed by a U.S. company, was the very first thing we sold out of in Japan. Or our muffins: Everyone thought that Japanese taste in sweets would be entirely different, but our bakery business, as a percentage of sales, is higher there than anywhere else.” *Jim Sinegal, CEO, Costco, August 2002***
- **“We're pleased with the progress we've made... We've been very methodical in the way we've approached and developed this market... We believe that the U.K. - a country of 60 million - can ultimately support between 40 and 50 clubs. That estimate is based on the same market requirements Costco has used to grow its U.S. business - population centers of 500,000 that include at least 15,000 viable small enterprises.” *Jim Murphy, Senior Vice President, European Operations, Costco, August 2002***
- **“Any new Costco stores will have a limited impact on mainstream retailers, but clearly this will affect others operating in the same market, such as Booker, Makro and independent cash-and-carry operators.” *Jim Sinegal, CEO, Costco, September 2001***

4. NEW COUNTRIES - ADDITIONAL PROPOSED/PLANNED MARKETS

Price/Costco have discussed a number of international markets that did not eventuate, however the Price and Costco names are registered throughout Europe and Asia-Pacific

Markets discussed

Market	Year Discussed	Notes
Spain	1991 1993	Costco announces plans with Carrefour Price Club plan "within two years"; location planned in Barcelona; Joint-venture with Centros Comerciales Ceco; to open Spring 94
France	1991	Joint-venture with Carrefour
Portugal	1993	Price Club plan "within two years"
Ireland	1994	Proposed site blocked by planning permission
Russia	1993	Discussed joint-venture with Littlewoods UK
Italy	1994	"Long term plans" announced in 1994
Singapore	1997	"Looking at"
Malaysia	1997	"Looking at"
Germany	1999	"Active" "a dialog"
Poland	2000	Under investigation
Australia	1994 2003	Rights to develop market given to PriceSmart spinoff (expired August 1999) Costco executives visit; confirm looking at country
New Zealand	1994 2003	Rights to develop market given to PriceSmart spinoff (expired August 1999) Costco executives visit; confirm looking at country

4. NEW COUNTRIES – FRANCE OR SPAIN?

In the early 1990's both Price and Costco discussed entering Continental Europe, a plan which has yet to eventuate

- "Costco Wholesale Co. here has plans to start Europe's first membership warehouse operation, probably in either France or Spain... We're still in the formative stage on what we'll do and where it will be, but plans should materialize soon... The project will be undertaken jointly with Carrefour." *Jeffrey Brotman, Chairman, July 1991*
- "The company has been talking about the idea for about two years... A key consideration in opening in Europe is determining what Costco would bring to the market that is different from the cash and carry stores already there. The European cash and carry industry, in fact, inspired the American membership warehouse concept. Sol Price based the Price Club, the pioneering wholesale club, on the cash and carry stores... Costco, and the American membership warehouse format, includes "twists" not found in Europe, including greater merchandising of fresh produce and bakery goods, a larger focus on non-food items and services like pharmacy. Customers of European cash and carries are mainly restaurants and small food stores and they don't have group members." *Jim Sinegal, CEO, Costco, August 1991*
- "Costco is striving to be the first American wholesale club in Europe so it can beat competitors, all of whom are also eyeing European expansion. A Costco exec told DSN earlier this year that European membership warehouses like Makro and the cash and carry stores weren't seen as a major competitive problem. These wholesale clubs aren't as sharply priced as American membership warehouses and carry a much broader assortment, which results in a lower turn and higher costs." *Discount Store News, March 1992*
- A Costco move into Europe comes after two unsuccessful European attempts to open membership warehouses in the United States. Makro, a major European cash and carry, opened a number of stores in the Northeast and the Midwest before selling a 51% interest to Kmart in March 1988. The discounter acquired the remaining 49% in November 1990, when at the same time it purchased Pace Membership Warehouse. Later, the Makros were converted to Pace clubs. Metro, another major European cash and carry, opened three clubs in Chicago, but sold these units to Zayre in 1986, which converted them to BJ's Wholesale Club." *Discount Store News, August 1991*

4. NEW COUNTRIES – EUROPEAN OPPORTUNITIES

Costco has long had aspirations to expand into Europe

- **“I think it has proven to be very transferable internationally. Sales performance in the international markets has been spectacular. Warehouses are achieving comps [comparative store sales] north of 20 and 30 percent for those stores in the comp base... What does make overseas expansion difficult, particularly in Asia, is the ability to secure a parcel of real estate large enough to accommodate a warehouse. However, the company has been creative and opportunistic in this regard.”** *Mary Corrigan, analyst, William Blair, November 1998*
- **“We have an interest in Europe and we've explored every major market on the continent. It would facilitate our entry to find a solid joint-venture partner.”** *Jim Murphy, Managing Director, Costco UK, August 1999*
- **“We are interested in a number of sites in Northern Ireland, and are out there talking to people in France, Germany, Spain, Italy and Poland. We're also looking at smaller markets. We don't necessarily require a partner. We entered Japan successfully without one. It's just a question of finding the right opportunity the right sites at the right price.”** *Jim Murphy, Senior Vice President, European Operations, Costco, November 2002*
- **“We see the company the development of a strong UK business as the springboard for European expansion... After completing a market assessment, we believe the concept can do well in Germany, France, Italy, Spain and possibly Poland. We have had a long search for European partners that could help with property, products and people.”** *Jim Murphy, Senior Vice President, European Operations, Costco, October 2000*

4. NEW COUNTRIES - AUSTRALIA AND NEW ZEALAND ON THE RADAR FOR 15 YEARS

Australia and New Zealand have been on the radar for more than fifteen years

- "We've had a number of approaches to go into Australia." *Sol Price, Founder, Price Club, March 1989*
- "Specified Geographical Areas shall mean Australia, New Zealand, the Northern Mariana Islands, the Republic of Panama..." *Agreement of transfer and plan of exchange between Price/Costco and Price Enterprises, July 28, 1994*
- "[Price Enterprises] has an exclusive right through August 1999 to conduct club businesses in Central America, most of the Caribbean, the Northern Mariana Islands, Australia and New Zealand, with certain trademark rights to the names Price Club, PriceCostco and Price Club Costco in these markets." *Price Enterprises 10K 1995*

4. NEW COUNTRIES – RECENT AUSTRALIA AND NEW ZEALAND VISIT

Costco executives visited Australia and New Zealand last year

- **“Three top executives from the multi-billion-dollar US discount retailer visited Auckland last weekend using a helicopter to investigate potential commercial sites in Auckland. They had also been viewing potential sites in Sydney and Melbourne.”** *The Independent, February 2003*
- **“Most of the analysts will tell you that a business like that needs a population of at least one million per store which means just one store in New Zealand at the moment. It's just not economic to open a business like that. Even if they opened two stores or used Australia as a distribution centre, the economics don't work for such a low number. You need a whole lot of infrastructure to run a business like that.”** *Greg Muir, CEO, The Warehouse, February 2003*
- **“I would have thought it highly unlikely that Costco would consider investing at the moment in a market such as New Zealand... the country does not have sufficient density of population to interest a bulk retailer such as Costco. It would be a very unlikely circumstance that someone would try and start from scratch.”** *Trevor Coates, Managing Director, FAL, February 2003*
- **“We are looking at lots of different countries all over Asia and Europe... We hadn't been to Australia and NZ before so we wanted to have a look before we sifted through our options... Australia is one of several countries under examination for international expansion... Any decision is six to 12 months away, or even more.”** *Jeffrey Brotman, Chairman, Costco, February 2003*
- **“The chairman of US warehouse club operation Costco, Jeffrey Brotman, has confirmed that Australia is one of several countries under examination for international expansion. This follows reports of top Costco executives investigating potential sites in both Australia and New Zealand last weekend. Any expansion by Costco into Australia would raise the heat even more for domestic giants Coles and Woolworths, which collectively hold about three-quarters of the grocery market, but are under pressure from German discounter Aldi, with some evidence of a resurgence by the independent sector.”** *Just Food, February 2003*

4. NEW COUNTRIES –COMPETITORS: KEY COMPETITORS

There are two major and two minor international players in wholesale clubs and two major international cash-and-carry operators

Facts and figures for key international players
Various, FY2003

Parent Company	Group Sales (\$m)	Fascia	Fascia Sales (\$m)	# of countries	# of units	Sales per unit	Average size (sqft)	# sku per unit	Notes
Major Wholesale Club operators									
Costco	\$42,546m	Costco	\$42,546m (ex-Mexico)	7	430	\$107.2m ⁴	137,000	4,000	23 Mexico units are 50% JV
Wal-Mart	\$256,329m	Sam's Club	\$34,537m ³ (US only)	5	538 US 80 intl	\$64.2m ³	124,000	4,000	53 Mexico units part of Wal-Mart de Mexico
PriceSmart	\$648.5m	PriceSmart	\$649m	16	41	\$23.2m ¹	40,000-50,000	4,000	Price/Costco spin-off
Cost-U-Less	\$177m	Cost-U-Less	\$177m	7	11	\$16.1m	30,000	3,000	Island strategy; failed entry attempt into New Zealand
Major Cash & Carry operators									
Metro AG	\$53,595m	Metro Cash & Carry	\$25,093m	26	475	\$52.8m	70,000-80,000	20,000-30,000	Traditional Cash&Carry operator; purchased part of Makro in the early 1990's
Makro SHV ²	\$10,272	Makro Cash & Carry	\$2,836m	9	140	\$20.3m	60,000-80,000	20,000-30,000	Stores in Asia and South America; shareholder in Massmart South Africa

4. NEW COUNTRIES – COMPETITORS: INTERNATIONAL EXPERIENCE TO DATE

International experience to date in exporting the wholesale club concept suggests it works best in Americanized and high-to-middle income countries

	Failure	Present	Success	Discussed
High-to-Middle Income	Hong Kong (Sam’s) New Zealand (Cost-U-Less)	Japan (Costco) Taiwan (Costco) Korea (Costco)	Canada (Costco, Loblaw, Sam’s) United Kingdom (Costco)	Australia (PriceSmart, Costco) New Zealand (PriceSmart, Costco) Portugal (Costco) Spain (Costco) Ireland (Costco) Italy (Costco) Germany (Costco) France (Costco)
Middle-to-Low Income	Argentina (Sam’s) Indonesia (PriceSmart) Guam (PriceSmart)	China (Sam’s, PriceSmart) Jamaica (PriceSmart) Barbados (PriceSmart) Aruba (PriceSmart) Trinidad (PriceSmart) Dominican Republic Nicaragua (PriceSmart) Honduras (PriceSmart) El Salvador (PriceSmart) Costa Rica (PriceSmart) Guatemala (PriceSmart) Panama (PriceSmart) Philippines (PriceSmart) Micronesia (PriceSmart) Guam (Cost-U-Less) US Virgin Is. (Cost-U-Less) Am. Samoa (Cost-U-Less) Fiji (Cost-U-Less) Neth. Antilles (Cost-U-Less)	Mexico (Costco, Sam’s, PriceSmart)	Poland (Costco) Russia (Price Club)

4. NEW COUNTRIES - COMPETITORS: SAM'S CLUB INTERNATIONAL UNITS

Sam's Club has 53 units in Mexico and 18 in three other countries; it has failed in Argentina and Hong Kong

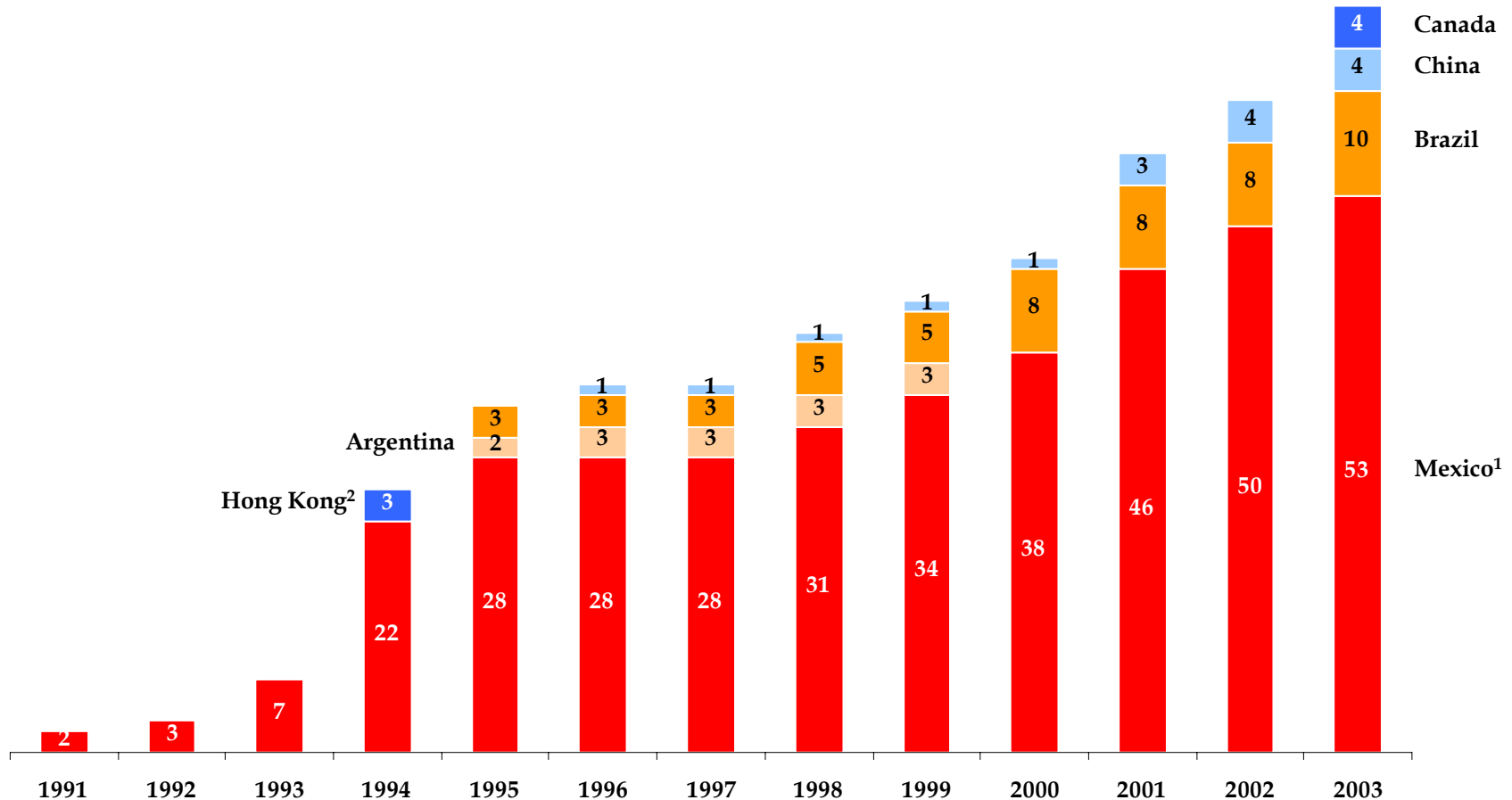
Sam's Club global locations
Units; FY2003



4. NEW COUNTRIES - COMPETITORS: SAM'S CLUB INTERNATIONAL UNITS

Sam's Club has not developed into an international growth vehicle of any significance for Wal-Mart anywhere other than as part of its Mexican joint-venture

Sam's Club international units by country by year
Units, FY1991-FY2003



4. NEW COUNTRIES - COMPETITORS: PRICESMART INTERNATIONAL LOCATIONS

PriceSmart, a Costco spin-off has 41 units in 16 countries

PriceSmart global locations
Units; FY2003



4. NEW COUNTRIES - COMPETITORS: REASON FOR PRICESMART SPIN-OFF

Price Enterprises (later PriceSmart) was spun-off from Costco following philosophical differences between management about strategy

- **“Following the Merger, certain basic philosophical differences developed between the former Costco executives and the former Price executives regarding management strategies central to the direction of PriceCostco's business operations. The former Costco executives believed that PriceCostco should devote its business resources primarily to its core warehouse club business, whereas the former Price executives believed that substantial resources should be devoted to... the Mexican joint venture... and Pacific Rim, Latin American and South American expansion. These differences were discussed in detail by the Board of Directors and senior management of PriceCostco, but not satisfactorily resolved.”** *Price Enterprises Prospectus (S4), September 1994*

4. NEW COUNTRIES – COMPETITORS: PRICESMART COUNTRIES OF OPERATION

PriceSmart has operations in 16 countries, most of which were entered via a joint-venture

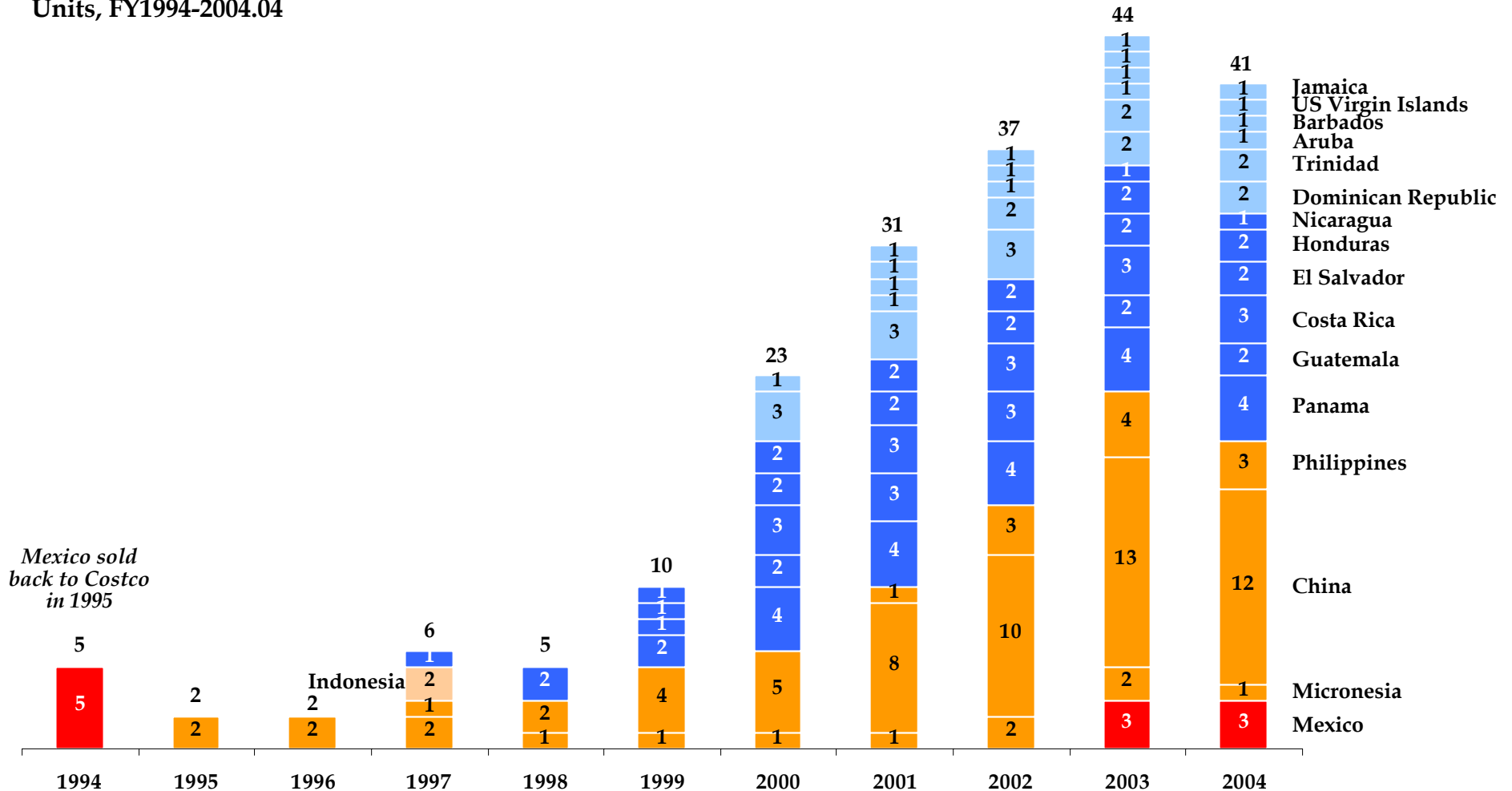
PriceSmart international units
Units, April 2004

Year	Country	Units (2004.4)	Notes
1995	Guam	-	One licensed unit closed in FY1998; other unit closed FY 2004
1995	Micronesia	1	Under license
1996	Panama	4	51% joint-venture with BB&M International; later acquired in exchange for PSMT shares
1996	Indonesia	-	License; 2 units (Medan & Jakarta); terminated license in FY 1998 during Asian crisis
1997	China	12	Independently run under license
1999	Costa Rica	3	60% joint-venture with PSC SA; later acquired in exchange for PSMT shares
1999	Dominican Republic	2	60% joint-venture with PSC SA; later acquired in exchange for PSMT shares
1999	El Salvador	2	60% joint-venture with PSC SA; later acquired in exchange for PSMT shares
1999	Guatemala	2	66% ownership; joint-venture with Grupo Solid
1999	Honduras	2	60% joint-venture with PSC SA; later acquired in exchange for PSMT shares
2000	Trinidad	2	62.5% ownership joint-venture with local business people; raised to 90%
2001	Philippines	3	52% ownership
2002	Aruba	1	60% ownership; later raised to 90% ownership in exchange for shares; option on remainder
2002	Barbados	1	51% ownership; later acquired for PSMT shares and cash
2003	US Virgin Islands	1	100% company owned
2003	Mexico	3	50/50 joint venture with Grupo Gigante SA
2003	Jamaica	1	67.5% ownership
2003	Nicaragua	1	51% ownership

4. NEW COUNTRIES - COMPETITORS: PRICESMART NUMBER OF UNITS

After a period of strong growth, the number of PriceSmart units has declined recently

PriceSmart international units by country by year
Units, FY1994-2004.04



4. NEW COUNTRIES – COMPETITORS: PRICESMART FINANCIAL TROUBLES

In 2003 PriceSmart had to restate earnings following due to improperly booked revenues

- “Sol Price is considered a demigod in retailing circles... But now the 87-year-old's legacy is being tinged by the still-unfolding fiasco at PriceSmart. The company was created to take the warehouse club concept to emerging markets like Latin America and the Caribbean... But this smart strategy failed miserably. Its once-impressive sales growth is beginning to look like a mirage. Last month PriceSmart said it would restate 2002 and 2003 results to correct improperly booked revenue and could lose more than \$20 million in the fourth quarter. Shares are down to \$6.75 from a high of \$49 in March 2000. Sales in the most recent fiscal year were \$660 million, up 5% as reported, but sales from stores open more than a year have fallen in each of the past six months. Most blame this mess on Gilbert Partida, the retailing novice hired as chief executive, who abruptly resigned in April. Some point fingers at Robert Price, the 61-year-old chairman of the board, for lack of oversight. But above all, investors say Sol Price should have been able to control a series of obvious missteps...

They told investors they would open 30 to 35 stores, each expected to pull in \$20 million to \$30 million annually, reaching \$1 billion within five years. In December 1997 the company hired Partida, a 35-year-old attorney and head of the San Diego Chamber of Commerce, to implement the strategy....

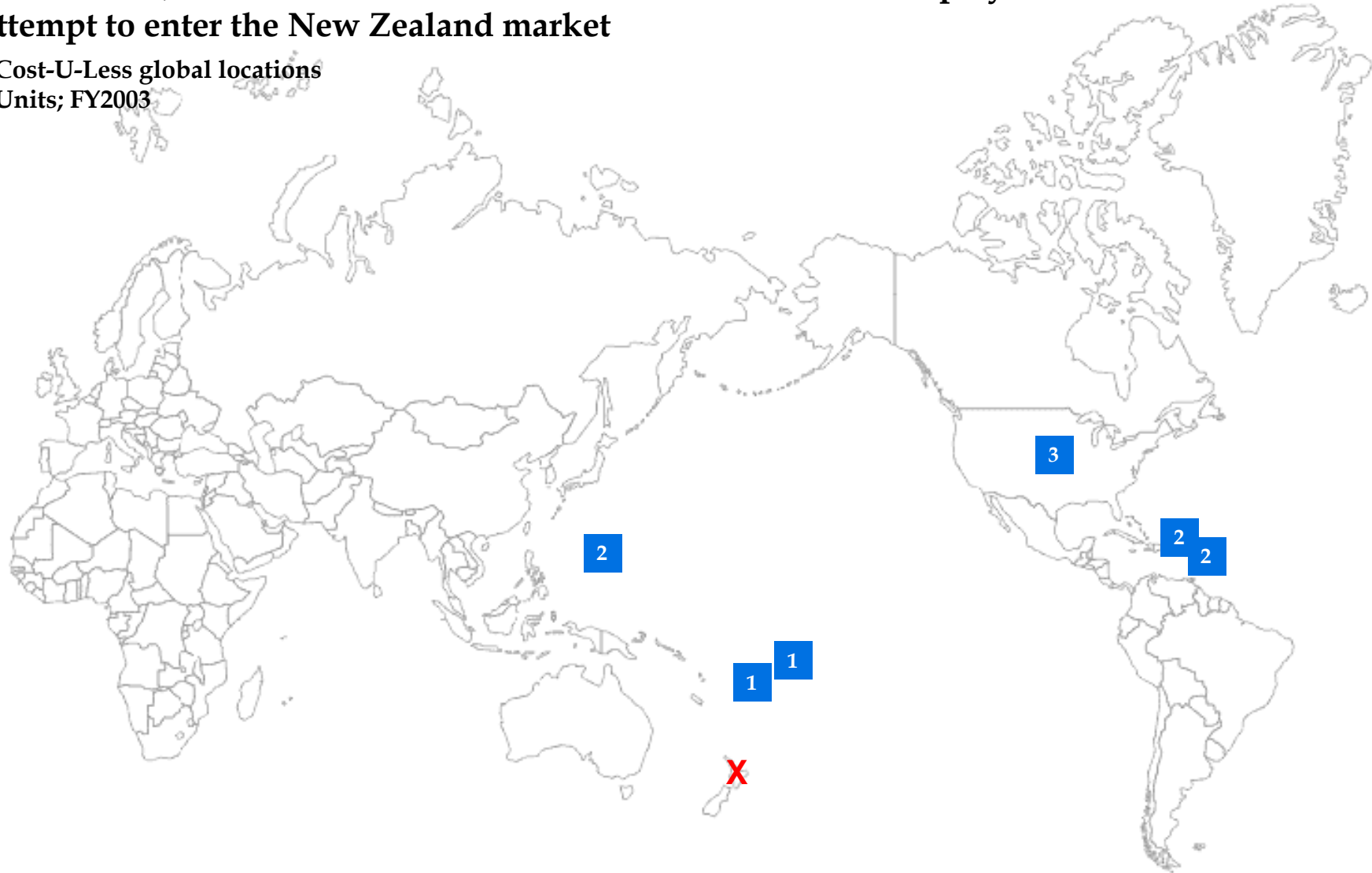
At first PriceSmart looked like a winner. Its first two stores in Panama saw combined annualized sales of \$60 million in 1998. Additional stores soon followed in Guatemala, El Salvador, Honduras and Costa Rica. By November 2001 PriceSmart had 22 stores in 11 countries... Partida was a skilled schmoozer who made sure store openings were regal events, often with a visit by the home country's prime minister. But he had no retail experience and had never run a company. "He made a lot of ego-driven decisions that were terrible," says Brian Warner, general partner of New York hedge fund Performance Capital...

After Partida left, the company began unwinding many of his moves. Interim Chief Robert Price terminated the phone card sales and began closing stores and cutting the revenue forecast. In July the company said that excluding phone card sales, same-store sales for the prior ten months fell 6%. The Prices have injected \$27 million into PriceSmart this year. After all, their name's on the door." *Forbes, December 2003*

4. NEW COUNTRIES - COMPETITORS: COST-U-LESS INTERNATIONAL UNITS

Cost-U-Less, with turnover of \$177m across 11 units is a minor player that failed in its brief attempt to enter the New Zealand market

Cost-U-Less global locations
Units; FY2003

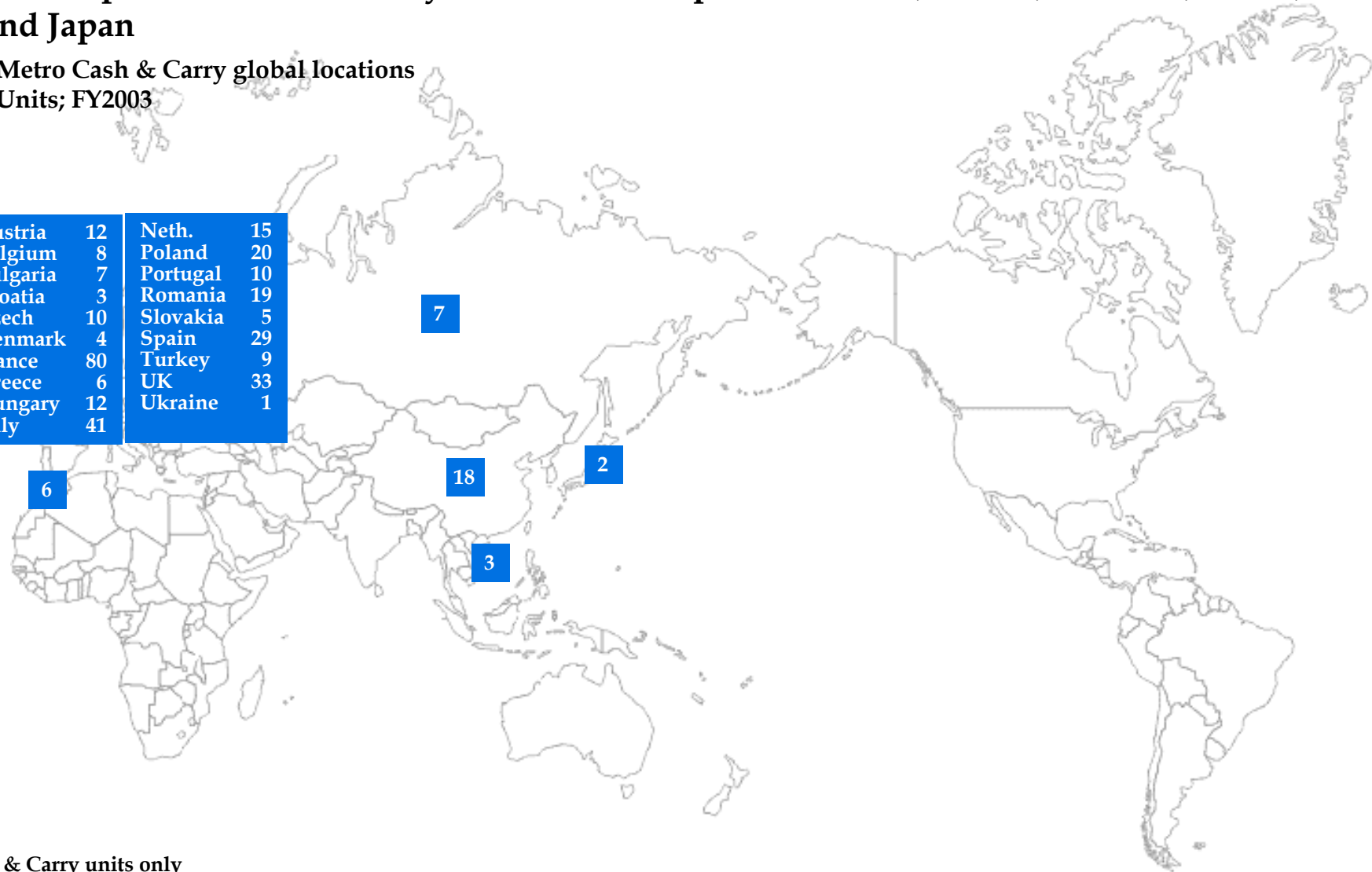


4. NEW COUNTRIES - COMPETITORS: METRO AG INTERNATIONAL UNITS

Metro operates cash-and-carry units in 19 European countries, Russia, Morocco, China, Vietnam and Japan

Metro Cash & Carry global locations
Units; FY2003

Austria	12	Neth.	15
Belgium	8	Poland	20
Bulgaria	7	Portugal	10
Croatia	3	Romania	19
Czech	10	Slovakia	5
Denmark	4	Spain	29
France	80	Turkey	9
Greece	6	UK	33
Hungary	12	Ukraine	1
Italy	41		

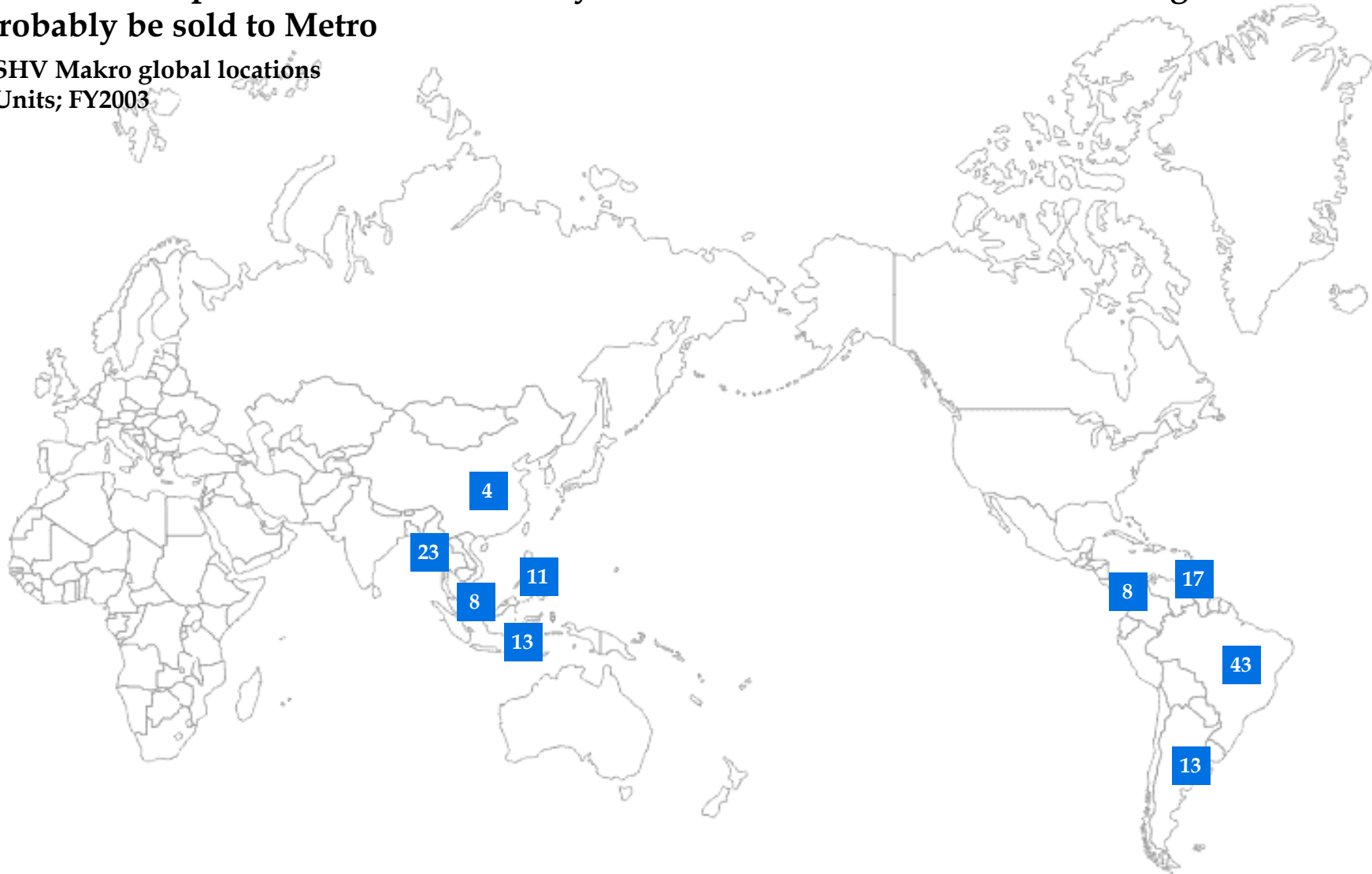


Cash & Carry units only

4. NEW COUNTRIES - COMPETITORS: SHV MAKRO INTERNATIONAL UNITS

SHV Makro operates 140 cash-and-carry units in nine countries and in the long-run will probably be sold to Metro

SHV Makro global locations
Units; FY2003



QUESTION THREE: WHAT NEXT?

Costco is at a crossroads - future sources of growth are unclear

Potential growth paths for Costco
Model



***“There’s no annuity in this business. You don’t have any guarantees.
You’re only as good as your latest act.”***

Jim Sinegal, CEO, Costco, July 1997