

Costco: Yay or Nay?

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Introduction: This report analyzes the financial and operational drivers' speed, loyalty, and valuation that distinguish high-performing 'compounders' like Costco from traditional value opportunities like Target and Walmart.

1. Regional Revenue & Loyalty: The US market remains the primary revenue driver. This concentration is anchored by elite customer loyalty, with a US/Canada renewal rate of 92.9%, significantly outperforming the 90.5% worldwide average.

2. Growth vs. Profitability Trends: While YoY revenue growth normalized following the 2021 peak, Net Income has increased. This indicates a successful strategic shift from raw volume to margin expansion and high-tier membership conversions.

3. Efficiency vs Valuation (DSI vs. P/E): Market valuation is directly tied to inventory velocity.

- **The Logic:** Costco's low DSI (27.8 days) creates a 'Negative Cash Conversion Cycle,' generating interest-free cash.
- **The Result:** Investors pay a Premium P/E (46.8x) for this speed. Conversely, Target's higher DSI (62.9 days) results in a lower P/E (11.1x) due to increased capital lock-up and markdown risks.

4. Membership Dynamics: The Conversion Funnel visualizes the journey from Total Cardholders (136.8M shoppers) down to Total Paid Members (76.2M payers). While broader base growth has stabilized, the high-value Executive tier now represents 46.5% of all paid members. This 'bottom-heavy' funnel highlights Costco's ability to upsell the most loyal users into premium profit tiers, driving consistent net income growth.

5. Investment Thesis: 'Great' vs. 'Good' Costco's outperformance of the S&P 500 supports Charlie Munger's 'Concentrated Quality' theory. While Target is 'Good' (undervalued at 11.1x P/E), Costco is 'Great.' Its rapid high-tier growth and 30.3% ROE compensate for its price premium, making it a 'Compounder' that builds wealth through operational excellence rather than low entry cost.

6. The 'Quality Premium' Logic: To some analysts, a valuation of 46.8x price-to-earnings appears overstretched; however, this overlooks the fundamental difference between a merchant and a membership club. By prioritizing the 'stickiness' of the Executive tier, Costco effectively trades immediate product margins for long-term, high-visibility cash flows. This strategic trade-off transforms the inventory risk found in traditional retail into a predictable, recurring annuity.

These figures reflect different business philosophies: Costco wins through high-velocity loyalty, Walmart through steady scale, and Target through a recovery-focused value narrative. Success in this sector is defined by turning inventory into cash and customers into fans.