Finance Project Executive Summary

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Although Costco and Target hold the rank of number two and three in sales in the retail industry, respectfully, these two companies operate on noticeably different philosophies. Costco requires a yearly membership and so limits its customer numbers whereas Target's population of shoppers is virtually unlimited. Costco employs around one third the workforce and offers a fraction of the skews that Target does giving merit to the bare-bones philosophy that it operates while demonstrating insignificant differences in revenue between the two.

The focus of this project, however, is not to analyze the ideals or approaches of these two multi-billion dollar companies' models but instead, to dig into common financial markers and demonstrate why Costco and Target lead the pack in the retail industry. Comparatively, there are several similar and different indicators between these companies including growth, debt-leverage, and profitability and these are indeed the focus of this project.

Growth Analysis

Sales growth rate in both companies is consistent with the exception of 2014 for Target where sales decreased slightly but recovers the subsequent year. Although Costco's sales growth rate diminishes over time, it does increase every year. Net income growth however is very different between the two. We notice that Target's growth in NI is near flat from 2011-2013 and later moving negative at -10%. Although growth is indeed negative, net income is still positive. Costco's net income growth ranges from 17% to 15% indicating a fairly steady growth over 5 years with the exception of only a slight increase in 2014, possibly due to an increase in long term debt the previous year.

Free cash flow is the money a company is able to generate after paying what is required to maintain or even expand its asset base. Both companies exhibit relatively small differences in dollars from year to year and so growth rate or lack-thereof appears significantly large and unstable with small fluctuations in actual dollars. Both Costco and Target have positive free cash flow in all years observed.

Debt and Leverage Analysis

The debt equity ratio for both companies is comparable and exhibits some leverage. Target's leverage has not changed much in 4 years and has maintained a ratio that is between 1.7 and 1.9 whereas Costco's range shows almost no leverage in 2011 at 1.1 and almost a 2:1 ratio in 2015, almost doubling in 4 years. Target is doing a great job consistently paying down its long term debt where Costco's LTD goes up over 300% from 2012 to 2013, from $1.5 billion to over $5 billion which is somewhat concerning seeing that net income is less than one third of its current, unpaid LTD of over $5 billion. We can only speculate that this long term debt was used for purchase of long term assets and is making a positive return which might be observed in the increase in free cash flow over time.

Profitability Analysis

When observing profitability, nothing really stands out as significant outside of the 2013 increase in ROE for Costco. It may be simply chance that the increase in long term debt for Costco in 2013 coincides with 5% of the Return On Equity in the same year. A more detailed analysis of financials might prove that this is just coincidence or may actually have some correlation.

Considering the success of both of these companies, the small profit margins exhibited over time might just be the industry standard. Investors can be confident that these numbers demonstrate consistent sales and positive returns reciprocating an overall stock price increase in the long run.

Dupont breakdown

We see a significant increase in Return on Equity with Costco but a potentially alarming indicator is an increase in ROE due to an increase in the Equity Multiplier. This might indicate that the company is employing more debt in relation to shareholders equity. Alternatively, Target's ROE is slightly decreasing due to a decrease in profit margin, another cautionary marker that is extracted from the Dupont formula.

All in all, Target and Costco's equity increases year after year and indicators that might lead to cautionary investment decisions with run of the mill companies should pose no alarm with these two sound investments as seen in stock chart comparisons between each other and the S&P 500.