

Investment Pitch: Costco (COST)

Recommendation: Short Position

Costco remains a highly admired retailer, driven by its membership model, customer loyalty, and consistent traffic growth. However, the valuation analysis across multiple approaches suggests that Costco's current stock price of ~\$961 far exceeds its intrinsic value, even under optimistic assumptions. We recommend a **short position** in Costco, supported by absolute valuation, relative multiples, and comparison with peers Walmart and Target.

1. Absolute Valuation (DCF / FCFE)

Using a two-stage Free Cash Flow to Equity (FCFE) model with an initial growth rate of 8%, a terminal growth rate of 2%, and a CAPM-based cost of equity of 9.61%, we estimate Costco's fair value at:

- **Intrinsic Value per Share:** ~\$175
- **Downside Potential:** ~82% relative to current trading price

Sensitivity analysis across WACC (7.6%–11.6%) and terminal growth rates (1%–3%) yields a valuation range of **\$138–\$238 per share**, confirming that Costco is priced well beyond any reasonable growth scenario.

2. Relative Valuation

- **Trailing P/E:** ~61× vs. Walmart ~28× and Target ~17×
- **Forward P/E:** ~54× vs. Walmart ~25× and Target ~15×
- **P/S Ratio:** ~1.7× vs. Walmart ~0.7× and Target ~0.6×

Relative to peers, Costco trades at **multiples 2-4x higher**, despite only modestly stronger revenue growth and similar margin profiles. This valuation premium reflects market over-optimism rather than fundamentals.

3. Competitive Comparison: Walmart and Target

- **Walmart:** More fairly valued, with a forward P/E in the mid-20s and broad exposure to e-commerce, international markets, and grocery. Its intrinsic valuation aligns more closely with its market price, suggesting limited mispricing.
- **Target:** Trades at a discount, with valuation multiples well below Costco's, reflecting near-term margin challenges. Despite this, Target's fair value estimate is closer to its stock price, making it more reasonably priced than Costco.

Against these peers, Costco's excessive premium stands out. Investors seeking exposure to retail would find **better risk-adjusted opportunities in Walmart or Target.**

4. Investment Thesis

- **Extreme Overvaluation:** DCF analysis points to 80% downside risk from current levels
- **Relative Mispricing:** Costco trades at multiples far beyond peers, despite comparable fundamentals
- **Asymmetric Risk/Reward:** With valuations this stretched, any slowdown in sales growth, membership renewal, or margin expansion could trigger a major correction

Conclusion

While Costco is an operationally excellent company with a strong brand and loyal member base, its current stock price is **unjustifiably high** relative to both intrinsic valuation and peer benchmarks. We recommend a **short position in Costco**, as the stock's risk/reward profile is heavily skewed to the downside.