

COSTCO WHOLESALE CORP /NEW

Form 10-Q

March 30, 2007

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended February 18, 2007

OR

" **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission file number 0-20355

Costco Wholesale Corporation

(Exact name of registrant as specified in its charter)

Washington
(State or other jurisdiction of
incorporation or organization)

999 Lake Drive, Issaquah, WA 98027

(Address of principal executive office)

(Zip Code)

(Registrant's telephone number, including area code): **(425) 313-8100**

91-1223280
(I.R.S. Employer

Identification No.)

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act) YES NO

The number of shares outstanding of the issuer's common stock as of March 23, 2007 was 446,645,498.

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COSTCO WHOLESALE CORPORATION

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PART I FINANCIAL INFORMATION

Item 1 Financial Statements

COSTCO WHOLESALE CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS

(dollars in thousands, except par value)

(unaudited)

	February 18, 2007	September 3, 2006
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 1,571,905	\$ 1,510,939
Short-term investments	661,414	1,322,181
Receivables, net	792,238	565,373
Merchandise inventories	4,930,855	4,568,723
Deferred income taxes and other current assets	319,353	264,866
Total current assets	8,275,765	8,232,082
PROPERTY AND EQUIPMENT		
Land	2,848,255	2,747,396
Buildings, leasehold and land improvements	6,644,646	6,241,357
Equipment and fixtures	2,570,158	2,405,229
Construction in progress	143,574	248,454
	12,206,633	11,642,436
Less accumulated depreciation and amortization	(3,289,862)	(3,078,141)
Net property and equipment	8,916,771	8,564,295
OTHER ASSETS		
	732,685	698,693
	\$ 17,925,221	\$ 17,495,070
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES		
Short-term borrowings	\$ 124,212	\$ 41,385
Accounts payable	4,961,747	4,581,395
Accrued salaries and benefits	1,272,336	1,080,382
Accrued sales and other taxes	233,817	324,274
Deferred membership income	654,207	583,946
Current portion of long-term debt	336,907	308,523
Other current liabilities	1,081,274	899,286
Total current liabilities	8,664,500	7,819,191
LONG-TERM DEBT, excluding current portion	168,020	215,369
DEFERRED INCOME TAXES AND OTHER LIABILITIES	238,153	253,713

Total liabilities	9,070,673	8,288,273
COMMITMENTS AND CONTINGENCIES		
MINORITY INTEREST	66,148	63,358
STOCKHOLDERS EQUITY		
Preferred stock \$.005 par value; 100,000,000 shares authorized; no shares issued and outstanding		
Common stock \$.005 par value; 900,000,000 shares authorized; 449,327,000 and 462,279,000 shares issued and outstanding	2,247	2,312
Additional paid-in capital	2,930,688	2,822,652
Accumulated other comprehensive income	244,995	277,263
Retained earnings	5,610,470	6,041,212
Total stockholders equity	8,788,400	9,143,439
	\$ 17,925,221	\$ 17,495,070

The accompanying notes are an integral part of these condensed consolidated financial statements.

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COSTCO WHOLESALE CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(dollars in thousands, except per share data)

(unaudited)

	12 Weeks Ended		24 Weeks Ended	
	February 18, 2007	February 12, 2006	February 18, 2007	February 12, 2006
REVENUE				
Net sales	\$ 14,804,696	\$ 13,789,246	\$ 28,657,017	\$ 26,460,038
Membership fees	307,320	269,766	606,623	532,320
Total revenue	15,112,016	14,059,012	29,263,640	26,992,358
OPERATING EXPENSES				
Merchandise costs	13,251,752	12,303,850	25,640,710	23,634,021
Selling, general and administrative	1,487,991	1,317,804	2,870,458	2,581,896
Preopening expenses	7,486	4,614	30,213	16,991
Provision for impaired assets and closing costs, net	3,459	1,428	7,791	2,639
Operating income	361,328	431,316	714,468	756,811
OTHER INCOME (EXPENSE)				
Interest expense	(3,620)	(2,923)	(5,760)	(6,647)
Interest income and other	36,526	35,225	63,637	60,765
INCOME BEFORE INCOME TAXES	394,234	463,618	772,345	810,929
Provision for income taxes	144,756	167,415	285,981	298,908
NET INCOME	\$ 249,478	\$ 296,203	\$ 486,364	\$ 512,021
NET INCOME PER COMMON SHARE:				
Basic	\$ 0.55	\$ 0.63	\$ 1.07	\$ 1.08
Diluted	\$ 0.54	\$ 0.62	\$ 1.05	\$ 1.06
Shares used in calculation (000 s)				
Basic	450,901	471,889	454,884	472,282
Diluted	461,575	482,127	465,149	484,294
Dividends per share	\$ 0.13	\$ 0.115	\$ 0.26	\$ 0.23

The accompanying notes are an integral part of these condensed consolidated financial statements.

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(dollars in thousands)

(unaudited)

	24 Weeks Ended	
	February 18, 2007	February 12, 2006
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 486,364	\$ 512,021
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	258,595	232,706
Stock-based compensation	64,899	43,031
Undistributed equity earnings in joint ventures	(17,099)	(12,998)
Net loss on sale of property and equipment and other	1,397	3,299
Accretion of discount on zero coupon notes	1,261	2,921
Excess tax benefit from exercise of stock options	(9,981)	(15,721)
Other	(5,867)	(12,425)
Change in deferred income taxes	(21,546)	(5,821)
Change in receivables, other current assets, deferred income, accrued and other current liabilities	64,613	361,213
Increase in merchandise inventories	(387,255)	(245,936)
Increase in accounts payable	290,534	94,592
Total adjustments	239,551	444,861
Net cash provided by operating activities	725,915	956,882
CASH FLOWS FROM INVESTING ACTIVITIES		
Additions to property and equipment, net of \$14,186 and \$4,796 of non-cash capital expenditures in the first half of fiscal 2007 and 2006, respectively	(661,741)	(508,420)
Proceeds from the sale of property and equipment	5,046	8,488
Purchases of short-term investments	(544,583)	(1,112,818)
Maturities of short-term investments	743,846	1,146,368
Sales of short-term investments	465,852	92,518
Change in other assets and other, net	(19,112)	(4,366)
Net cash used in investing activities	(10,692)	(378,230)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from short-term borrowings, net	81,484	9,501
Proceeds from issuance of long-term debt, net	2,567	4,627
Repayments of long-term debt	(3,362)	(2,347)
Change in bank checks outstanding	125,068	77,442
Cash dividend payments	(59,358)	(54,756)
Change in minority interests	2,789	2,567
Excess tax benefit from exercise of stock options	9,981	15,721
Exercise of stock options	113,555	138,881
Repurchases of common stock	(918,756)	(611,474)
Net cash used in financing activities	(646,032)	(419,838)
EFFECT OF EXCHANGE RATE CHANGES ON CASH	(8,225)	18,387
Net increase in cash and cash equivalents	60,966	177,201
CASH AND CASH EQUIVALENTS BEGINNING OF YEAR	1,510,939	2,062,585

CASH AND CASH EQUIVALENTS END OF PERIOD	\$ 1,571,905	\$ 2,239,786
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SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:

Cash paid during the period for:

Interest (excludes \$5,246 and \$5,037 interest capitalized in the first half of fiscal 2007 and 2006, respectively)	\$ 4,940	\$ 2,592
Income taxes	\$ 401,194	\$ 197,208

SUPPLEMENTAL DISCLOSURE OF NON-CASH FINANCING ACTIVITIES:

Common stock issued upon conversion of 3 1/2% Zero Coupon Convertible Subordinated Notes	\$ 14,143	\$ 164,872
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The accompanying notes are an integral part of these condensed consolidated financial statements.

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COSTCO WHOLESALE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

(unaudited)

NOTE (1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q for interim financial reporting pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). While these statements reflect all normal recurring adjustments which are, in the opinion of management, necessary for fair presentation of the results of the interim period, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. Therefore, the interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in the Company's annual report filed on Form 10-K for the fiscal year ended September 3, 2006.

The condensed consolidated financial statements include the accounts of Costco Wholesale Corporation, a Washington corporation, and its subsidiaries (Costco or the Company). All material inter-company transactions between the Company and its subsidiaries have been eliminated in consolidation.

Costco operates membership warehouse clubs that offer low prices on a limited selection of nationally branded and selected private label products in a wide range of merchandise categories in no-frills, self-service warehouse facilities. At February 18, 2007, Costco operated 504 warehouse clubs: 367 in the United States and four in Puerto Rico; 70 in Canada; 19 in the United Kingdom; five in Korea; four in Taiwan; five in Japan; and 30 in Mexico (through a 50%-owned joint venture, Costco Mexico). The Company's investments in Costco Mexico and in other unconsolidated joint ventures that are less than majority owned are accounted for under the equity method.

Merchandise Inventories

Merchandise inventories are valued at the lower of cost or market, as determined primarily by the retail method of accounting, and are stated using the last-in, first-out (LIFO) method for substantially all U.S. merchandise inventories. Merchandise inventories