COSTCO WHOLESALE CORP /NEW
Form 10-Q
March 20, 2013
Table of Contents

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 17, 2013

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	**91-1223280**
(State or other jurisdiction of	(I.R.S. Employer
incorporation or organization)	Identification No.)

999 Lake Drive, Issaquah, WA 98027

(Address of principal executive office)

(Zip Code)

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

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 x NO ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES x NO ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of large accelerated filer , accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer x	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller company)	Smaller reporting company ¨

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

The number of shares outstanding of the issuer s common stock as of March 13, 2013 was 436,371,394

Table of Contents

COSTCO WHOLESALE CORPORATION

INDEX TO FORM 10-Q

Table of Contents

PART I FINANCIAL INFORMATION

Item 1 Financial Statements

COSTCO WHOLESALE CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(dollars in millions, except par value and share data)

(unaudited)

	February 17, 2013	September 2, 2012
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 4,413	$ 3,528
Short-term investments	1,238	1,326
Receivables, net	1,300	1,026
Merchandise inventories	7,582	7,096
Deferred income taxes and other current assets	577	550
Total current assets	15,110	13,526
PROPERTY AND EQUIPMENT		
Land	4,236	4,032
Buildings and improvements	11,196	10,879
Equipment and fixtures	4,451	4,261
Construction in progress	436	374
	20,319	19,546
Less accumulated depreciation and amortization	(6,933)	(6,585)
Net property and equipment	13,386	12,961
OTHER ASSETS	593	653
TOTAL ASSETS	$ 29,089	$ 27,140
LIABILITIES AND EQUITY		
CURRENT LIABILITIES		
Short-term borrowings	$ 64	$ 0
Accounts payable	7,441	7,303
Accrued salaries and benefits	2,077	1,832
Accrued member rewards	694	661
Accrued sales and other taxes	415	397
Deferred membership fees	1,199	1,101
Other current liabilities	1,155	966
Total current liabilities	13,045	12,260
LONG-TERM DEBT, excluding current portion	4,806	1,381
DEFERRED INCOME TAXES AND OTHER LIABILITIES	955	981

Total liabilities	18,806	14,622
COMMITMENTS AND CONTINGENCIES		
EQUITY		
Preferred stock $.005 par value; 100,000,000 shares authorized; no shares issued and outstanding	0	0
Common stock $.005 par value; 900,000,000 shares authorized; 436,336,000 and 432,350,000 shares issued and outstanding	2	2
Additional paid-in capital	4,521	4,369
Accumulated other comprehensive income	111	156
Retained earnings	5,478	7,834
Total Costco stockholders equity	10,112	12,361
Noncontrolling interests	171	157
Total equity	10,283	12,518
TOTAL LIABILITIES AND EQUITY	$ 29,089	$ 27,140

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

Table of Contents

COSTCO WHOLESALE CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(dollars in millions, except per share data)

(unaudited)

	12 Weeks Ended		24 Weeks Ended	
	February 17, 2013	**February 12, 2012**	**February 17, 2013**	**February 12, 2012**
REVENUE				
Net sales	$ 24,343	$ 22,508	$ 47,547	$ 43,689
Membership fees	528	459	1,039	906
Total revenue	24,871	22,967	48,586	44,595
OPERATING EXPENSES				
Merchandise costs	21,766	20,139	42,492	39,070
Selling, general and administrative	2,361	2,178	4,693	4,322
Preopening expenses	6	6	24	16
Operating income	738	644	1,377	1,187
OTHER INCOME (EXPENSE)				
Interest expense	(25)	(27)	(38)	(54)
Interest income and other, net	26	10	46	47
INCOME BEFORE INCOME TAXES	739	627	1,385	1,180
Provision for income taxes	185	215	410	440
Net income including noncontrolling interests	554	412	975	740
Net income attributable to noncontrolling interests	(7)	(18)	(12)	(26)
NET INCOME ATTRIBUTABLE TO COSTCO	$ 547	$ 394	$ 963	$ 714
NET INCOME PER COMMON SHARE ATTRIBUTABLE TO COSTCO:				
Basic	$ 1.26	$ 0.91	$ 2.22	$ 1.64
Diluted	$ 1.24	$ 0.90	$ 2.19	$ 1.62
Shares used in calculation (000 s)				
Basic	435,975	434,535	434,698	434,374
Diluted	439,812	439,468	439,222	440,036
CASH DIVIDENDS DECLARED PER COMMON SHARE	$ 7.275	$ 0.240	$ 7.550	$ 0.480

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

Table of Contents

COSTCO WHOLESALE CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(dollars in millions)

(unaudited)

	12 Weeks Ended		24 Weeks Ended	
	February 17, 2013	**February 12, 2012**	**February 17, 2013**	**February 12, 2012**
NET INCOME INCLUDING NONCONTROLLING INTERESTS	$ 554	$ 412	$ 975	$ 740
Foreign-currency translation adjustment and other, net	(65)	132	(43)	(77)
Comprehensive income	489	544	932	663
Less: Comprehensive income attributable to noncontrolling interests	4	49	14	16
COMPREHENSIVE INCOME ATTRIBUTABLE TO COSTCO	$ 485	$ 495	$ 918	$ 647

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

4

Table of Contents

COSTCO WHOLESALE CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(dollars in millions)

(unaudited)

	24 Weeks Ended	
	February 17, 2013	**February 12, 2012**
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income including noncontrolling interests	$ 975	$ 740
Adjustments to reconcile net income including noncontrolling interests to net cash provided by operating activities:		
Depreciation and amortization	430	414
Stock-based compensation	159	134
Excess tax benefits on stock-based awards	(51)	(40)
Other non-cash operating activities, net	(12)	19
Deferred income taxes	33	(7)
Changes in operating assets and liabilities:		
Increase in merchandise inventories	(522)	(327)
Increase/(decrease) in accounts payable	237	(75)
Other operating assets and liabilities, net	276	386
Net cash provided by operating activities	1,525	1,244
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of short-term investments	(1,116)	(869)
Maturities of short-term investments	1,073	867
Sales of investments	120	191
Additions to property and equipment	(943)	(632)
Other investing activities, net	11	(9)
Net cash used in investing activities	(855)	(452)
CASH FLOWS FROM FINANCING ACTIVITIES		
Change in bank checks outstanding	(63)	(77)
Repayments of short-term borrowings	(110)	(117)
Proceeds from short-term borrowings	183	117
Proceeds from issuance of long-term debt	3,496	129
Distribution to noncontrolling interests	(22)	0
Proceeds from exercise of stock options	35	39
Minimum tax withholdings on stock-based awards	(117)	(104)
Excess tax benefits on stock-based awards	51	40
Repurchases of common stock	(36)	(312)
Cash dividend payments	(3,169)	(105)
Other financing activities, net	(13)	(2)
Net cash provided by (used in) financing activities	235	(392)
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	(20)	(20)
Net increase in cash and cash equivalents	885	380

CASH AND CASH EQUIVALENTS BEGINNING OF YEAR		3,528		4,009
CASH AND CASH EQUIVALENTS END OF PERIOD	$	4,413	$	4,389
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:				
Cash paid during the first half of year for:				
Interest (reduced by $8 and $4 interest capitalized in 2013 and 2012, respectively)	$	31	$	56
Income taxes	$	428	$	363
SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:				
Unsettled repurchases of common stock	$	0	$	6
Decrease in accrued property and equipment	$	(12)	$	(66)
Property acquired under capital lease	$	11	$	0
Common stock issued upon conversion of 3.5% Zero Coupon Convertible Subordinated Notes	$	29	$	1
Cash dividend declared, but not yet paid	$	120	$	104

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

Table of Contents

COSTCO WHOLESALE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(dollars in millions, except share data)

(unaudited)

Note 1 Summary of Significant Policies

Description of Business

Costco Wholesale Corporation and its subsidiaries operate membership warehouses based on the concept that offering members low prices on a limited selection of nationally branded and select private-label products in a wide range of merchandise categories will produce high sales volumes and rapid inventory turnover. At February 17, 2013, Costco operated 622 warehouses worldwide: 448 United States (U.S.) locations (in 41 U.S. states, Washington, D.C., and Puerto Rico), 85 Canadian locations, 32 Mexico locations, 23 United Kingdom (U.K.) locations, 13 Japan locations, 9 Taiwan locations, 9 Korea locations, and 3 Australia locations. The Company also operates online businesses at costco.com in the U.S, costco.ca in Canada, and costco.co.uk in the U.K.

Basis of Presentation

The consolidated financial statements include the accounts of Costco Wholesale Corporation, a Washington corporation, its wholly-owned subsidiaries, subsidiaries in which it has a controlling interest, consolidated entities in which it has made equity investments, or has other interests through which it has majority-voting control or it exercises the right to direct the activities that most significantly impact the entity s performance (Costco or the Company). The Company reports noncontrolling interests in consolidated entities as a component of equity separate from the Company s equity. All material inter-company transactions between and among the Company and its consolidated subsidiaries and other consolidated entities have been eliminated in consolidation. In July 2012, Costco purchased its former joint venture partner s 50% equity interest in Costco Mexico. The Company s net income excludes income attributable to noncontrolling interests in its operations in Mexico prior to the July 2012 acquisition of the 50% noncontrolling interest, Taiwan, and Korea. After the acquisition date, 100% of Mexico s operations are included in net income attributable to Costco. Unless otherwise noted, references to net income relate to net income attributable to Costco.

These 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 that 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 (GAAP) 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 2, 2012.

Fiscal Year End

The Company operates on a 52/53-week fiscal year basis with the fiscal year ending on the Sunday closest to August 31. References to the second quarters of 2013 and 2012 relate to the twelve week fiscal quarters ended February 17, 2013, and February 12, 2012, respectively. References to the first half of 2013 and 2012 relate to the twenty-four weeks ended February 17, 2013, and February 12, 2012, respectively.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of con-

Note 1 Summary of Significant Policies (Continued)

tingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates and assumptions.

Reclassifications

Certain reclassifications have been made to prior fiscal year amounts or balances to conform to the presentation in the current fiscal year. These reclassifications did not have a material impact on the Company s previously reported condensed consolidated financial statements.

Fair Value of Financial Instruments

The carrying value of the Company s financial instruments, including cash and cash equivalents, receivables and accounts payable, approximate fair value due to their short-term nature or variable interest rates. See Notes 2, 3, and 4 for the carrying value and fair value of the Company s investments, derivative instruments, and fixed-rate debt, respectively.

The Company accounts for certain assets and liabilities at fair value. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the measurement date. Fair value is estimated by applying a fair value hierarchy, which requires maximizing the use of observable inputs when measuring fair value. The three levels of inputs are:

Level 1:	Quoted market prices in active markets for identical assets or liabilities.
Level 2:	Observable market-based inputs or unobservable inputs that are corroborated by market data.
Level 3:	Significant unobservable inputs that are not corroborated by market data.

The Company s current financial liabilities have fair values that approximate their carrying values. The Company s long-term financial liabilities consist of long-term debt, which is recorded on the balance sheet at issuance price and adjusted for any applicable unamortized discounts or premiums. There have been no material changes to the valuation techniques utilized in the fair value measurement of assets and liabilities as disclosed in the Company s Form 10-K for the fiscal year ended September 2, 2012.

Merchandise Inventories

Merchandise inventories are valued at the lower of cost or market, as determined primarily by the retail inventory method, and are stated using the last-in, first-out (LIFO) method for substantially all U.S. merchandise inventories. Merchandise inventories for all foreign operations are primarily valued by the retail inventory method and are stated using the first-in, first-out (FIFO) method. The Company believes the LIFO method more fairly presents the results of operations by more closely matching current costs with current revenues. The Company records an adjustment each quarter, if necessary, for the projected annual effect of inflation or deflation, and these estimates are adjusted to actual results determined at year-end, when actual inflation rates and inventory levels have been determined.

Due to overall deflationary trends in the second quarter and first half of 2013, a benefit of $9 and $11 was recorded to merchandise costs, respectively, to reduce the cumulative LIFO valuation on merchandise inventories. Due to overall net inflationary trends, a charge to merchandise costs of $3 was recorded in the second quarter and first half of 2012. At February 17, 2013, and September 2, 2012, the cumulative impact of the LIFO valuation on merchandise inventories was $97 and $108, respectively.

Derivatives

The Company is exposed to foreign-currency exchange-rate fluctuations in the normal course of business. The Company manages these fluctuations, in part, through the use of forward foreign-exchange contracts,

Table of Contents

Note 1 Summary of Significant Policies (Continued)

seeking to economically hedge the impact of fluctuations of foreign exchange on known future expenditures denominated in a non-functional foreign-currency. The contracts are intended primarily to economically hedge exposure to U.S. dollar merchandise inventory expenditures made by the Company s international subsidiaries, whose functional currency is not the U.S. dollar. Currently, these contracts do not qualify for derivative hedge accounting. The Company seeks to mitigate risk with the use of these contracts and does not intend to engage in speculative transactions. These contracts do not contain any credit-risk-related contingent features. The aggregate notional amounts of open, unsettled forward foreign-exchange contracts were $275 and $284 at February 17, 2013 and September 2, 2012, respectively.

The Company seeks to manage counterparty risk associated with these contracts by limiting transactions to counterparties with which the Company has an established banking relationship. There can be no assurance, however, that this practice effectively mitigates counterparty risk. The contracts are limited to less than one year in duration. See Note 3 for information on the fair value of open, unsettled forward foreign-exchange contracts as of February 12, 2013, and September 2, 2012.

The unrealized gains or losses recognized in interest income and other, net in the accompanying condensed consolidated statements of income relating to the net changes in the fair value of open, unsettled forward foreign-exchange contracts were immaterial in the second quarter and the first half of 2013 and 2012.

The Company is exposed to fluctuations in prices for the energy it consumes, particularly electricity and natural gas, which it seeks to partially mitigate through the use of fixed-price contracts for certain of its warehouses and other facilities, primarily in the U.S. and Canada. The Company also enters into variable-priced contracts for some purchases of natural gas, in addition to fuel for its gas stations, on an index basis. These contracts meet the characteristics of derivative instruments, but generally qualify for the normal purchases or normal sales exception under authoritative guidance and thus require no mark-to-market adjustment.

Foreign Currency

The Company recognizes foreign-currency transaction gains and losses related to revaluing all monetary assets and revaluing or settling monetary liabilities denominated in currencies other than the functional currency in interest income and other, net in the accompanying condensed consolidated statements of income. Generally, this includes the U.S. dollar cash and cash equivalents and the U.S. dollar payables of consolidated subsidiaries to their functional currency. Also included are realized foreign-currency gains or losses from all settlements of forward foreign-exchange contracts. These items resulted in a net gain of $6 and $15 in the second quarter and first half of 2013, respectively, as compared to a net gain of $3 and $23 in the second quarter and first half of 2012, respectively.

Stock Repurchase Programs

Repurchased shares of common stock are retired, in accordance with the Washington Business Corporation Act. The par value of repurchased shares is deducted from common stock and the excess of repurchase price over par value is deducted from additional paid-in capital and retained earnings. See Note 5 for additional information.

Recently Adopted Accounting Pronouncements

In June 2011, the Financial Accounting Standards Board (FASB) issued guidance that eliminated the option to report other comprehensive income and its components in the statement of changes in equity. Instead, an entity is required to present either a continuous statement of net income and other comprehensive income or to present the information in two separate but consecutive statements. The new guidance must be applied retrospectively and is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The Company adopted this guidance at the beginning of its first quarter of 2013.

Table of Contents

Note 1 Summary of Significant Policies (Continued)

In September 2011, the FASB issued guidance to amend and simplify the rules related to testing goodwill for impairment. The revised guidance allows an initial qualitative evaluation, based on the entity s events and circumstances, to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. The results of this qualitative assessment determine whether it is necessary to perform the currently required two-step impairment test. The new guidance is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. The Company adopted this guidance at the beginning of its first quarter of 2013. Adoption of this guidance had no impact on the condensed consolidated financial statements.

Recent Accounting Pronouncements Not Yet Adopted

In February 2013, the FASB issued guidance to provide enhanced disclosures related to reclassifications out of accumulated other comprehensive income. An entity will be required to disclose the net income line items impacted by significant reclassifications out of accumulated other comprehensive income if the item is reclassified in its entirety. For other amounts that are not required to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other disclosures required under U.S. GAAP that provide additional detail about those amounts. The new guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2012. The Company plans to adopt this guidance at the beginning of its first quarter of fiscal year 2014. Adoption of this guidance is not expected to have a material impact on the Company s condensed consolidated financial statements or disclosures.

Note 2 Investments

The Company s major categories of investments have not changed from the annual reporting period ended September 2, 2012. The Company s investments at February 17, 2013, and September 2, 2012, were as follows:

February 17, 2013:	**Cost Basis**	**Unrealized Gains**	**Recorded Basis**
Available-for-sale:			
U.S. government and agency securities	$ 667	$ 4	$ 671
Corporate notes and bonds	10	0	10
Asset and mortgage-backed securities	6	0	6
Total available-for-sale	683	4	687
Held-to-maturity:			
Certificates of deposit	551		551
Total short-term investments	$ 1,234	$ 4	$ 1,238

September 2, 2012:	**Cost Basis**	**Unrealized Gains**	**Recorded Basis**
Available-for-sale:			
U.S. government and agency securities	$ 776	$ 6	$ 782
Corporate notes and bonds	54	0	54
FDIC-insured corporate bonds	35	0	35
Asset and mortgage-backed securities	8	0	8
Total available-for-sale	873	6	879
Held-to-maturity:			
Certificates of deposit	447		447
Total short-term investments	$ 1,320	$ 6	$ 1,326

Table of Contents

Note 2 Investments (Continued)

As of February 17, 2013, and September 2, 2012, the Company s available-for-sale securities that were in continuous unrealized-loss positions were not material. Gross unrealized gains and losses on cash equivalents were not material at February 17, 2013, and September 2, 2012.

The proceeds from sales of available-for-sale securities during the second quarter and the first half of 2013 and 2012 are provided in the following table:

	12 Weeks Ended		24 Weeks Ended	
	February 17, 2013	**February 12, 2012**	**February 17, 2013**	**February 12, 2012**
Proceeds	$ 59	$ 96	$ 120	$ 191

Gross realized gains or losses from sales of available-for-sale securities during the second quarter and the first half of 2013 and 2012 were not material.

The maturities of available-for-sale and held-to-maturity securities at February 17, 2013, were as follows:

	Available-For-Sale		Held-To-
	Cost Basis	**Fair Value**	**Maturity**
Due in one year or less	$ 425	$ 425	$ 551
Due after one year through five years	255	260	0
Due after five years	3	2	0
	$ 683	$ 687	$ 551

10

Table of Contents

Note 3 Fair Value Measurement

Assets and Liabilities Measured at Fair Value on a Recurring Basis

The tables below present information as of February 17, 2013, and September 2, 2012, respectively, regarding the Company s financial assets and financial liabilities that are measured at fair value on a recurring basis and indicate the level within the fair value hierarchy reflecting the valuation techniques utilized to determine such fair value. As of February 17, 2013, the Company did not hold any Level 3 financial assets and liabilities that are measured at fair value on a recurring basis. As of September 2, 2012, the Company s holdings of Level 3 financial assets and liabilities were immaterial.

February 17, 2013:	**Level 1**	**Level 2**
Money market mutual funds [1]	$ 87	$ 0
Investment in U.S. government and agency securities [2]	0	686
Investment in corporate notes and bonds	0	10
Investment in asset and mortgage-backed securities	0	6
Forward foreign exchange contracts, in asset position [3]	0	5
Forward foreign exchange contracts, in (liability) position [3]	0	(1)
Total	$ 87	$ 706

September 2, 2012:	**Level 1**	**Level 2**
Money market mutual funds [1]	$ 77	$ 0
Investment in U.S. government and agency securities [2]	0	794
Investment in corporate notes and bonds	0	54
Investment in FDIC-insured corporate bonds	0	35
Investment in asset and mortgage-backed securities	0	8
Forward foreign exchange contracts, in asset position [3]	0	1
Forward foreign exchange contracts, in (liability) position [3]	0	(3)
Total	$ 77	$ 889

(1) Included in cash and cash equivalents in the accompanying condensed consolidated balance sheets.

(2) On February 17, 2013, $15 and $671 included in cash and cash equivalents and short-term investments, respectively, in the accompanying condensed consolidated balance sheets. On September 2, 2012, $12 and $782 included in cash and cash equivalents and short-term investments, respectively, in the accompanying condensed consolidated balance sheets.

(3) The asset and the liability values are included in deferred income taxes and other current assets and other current liabilities, respectively, in the accompanying condensed consolidated balance sheets. See Note 1 for additional information on derivative instruments.

There were no financial assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) during the second quarter and first half of 2013, and they were immaterial during the second quarter and first half of 2012. There were no transfers in or out of Level 1, 2, or 3 during the second quarter and first half of 2013 and 2012.

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

Financial assets measured at fair value on a nonrecurring basis include held-to-maturity investments that are carried at amortized cost and are not remeasured to fair value on a recurring basis. There were no fair value adjustments to these financial assets during the second quarter and first half of 2013 and 2012.

Note 3 Fair Value Measurement (Continued)

Nonfinancial assets measured at fair value on a nonrecurring basis include items such as long-lived assets that are measured at fair value resulting from an impairment, if deemed necessary. There were no fair value adjustments to these nonfinancial assets and liabilities during the second quarter and first half of 2013. In the second quarter and first half of 2012, these adjustments were immaterial.

Note 4 Debt

The carrying value and estimated fair value of the Company s long-term debt consisted of the following:

	February 17, 2013		September 2, 2012	
	Carrying Value	Fair Value	Carrying Value	Fair Value
5.5% Senior Notes due March 2017	$ 1,098	$ 1,291	$ 1,097	$ 1,325
0.65% Senior Notes due December 2015	1,199	1,204	0	0
1.125% Senior Notes due December 2017	1,100	1,100	0	0
1.7% Senior Notes due December 2019	1,197	1,191	0	0
Other long-term debt	213	224	285	338
Total long-term debt	4,807	5,010	1,382	1,663
Less current portion	1	1	1	1
Long-term debt, excluding current portion	$ 4,806	$ 5,009	$ 1,381	$ 1,662

The current portion of long-term debt is included in other current liabilities in the accompanying condensed consolidated balance sheets. The estimated fair value of the Company s debt was based primarily on reported market values, recently completed market transactions and estimates based upon interest rates, maturities, and credit. Substantially all of the Company s long-term debt is classified as Level 2.

On December 7, 2012, the Company issued $3,500 in aggregate principal amount of Senior Notes as follows:

$1,200 of 0.65% Senior Notes due December 7, 2015. Interest is due semi-annually on June 7 and December 7, with the first payment due on June 7, 2013;

$1,100 of 1.125% Senior Notes due December 15, 2017. Interest is due semi-annually on June 15 and December 15, with the first payment due on June 15, 2013; and

$1,200 of 1.7% Senior Notes due December 15, 2019. Interest is due semi-annually on June 15 and December 15, with the first payment due on June 15, 2013.

Note 5 Equity and Comprehensive Income

Dividends

The Company s current quarterly dividend rate is $0.275 per share, compared to $0.24 per share in the second quarter of 2012. On November 28, 2012, the Board of Directors declared a special cash dividend on Costco common stock of $7.00 per share, which was paid on December 18, 2012, to shareholders of record as of the close of business on December 10, 2012. The aggregate payment was approximately $3,049.

Stock Repurchase Programs

There was no stock repurchase activity in the second quarter of 2013. In the second quarter of 2012, we repurchased 1,759,000 shares, at an average price of $82.20, totaling $145. In the first half of 2013 and 2012, we repurchased 357,000 shares and 3,881,000 shares, at an average price of $96.41 and $81.84, for a total expenditure of $34 and $318, respectively. The remaining amount available to be purchased under our approved plan was $3,055 at February 17, 2013. These amounts differ from the

Table of Contents

Note 5 Equity and Comprehensive Income (Continued)

stock repurchase balances in the condensed consolidated statements of cash flows due to changes in unsettled stock repurchases at the end of the quarter. Purchases are made from time-to-time, as conditions warrant, in the open market or in block purchases, and pursuant to plans under SEC Rule 10b5-1. Repurchased shares are retired, in accordance with the Washington Business Corporation Act.

Components of Equity and Comprehensive Income

The following tables show the changes in equity attributable to Costco and the noncontrolling interests of consolidated subsidiaries and other entities in which the Company has a controlling interest, but not a total ownership interest:

	Attributable to Costco	Noncontrolling Interests	Total Equity
Equity at September 2, 2012	$ 12,361	$ 157	$ 12,518
Comprehensive income:			
Net income	963	12	975
Foreign-currency translation adjustment and other, net	(45)	2	(43)
Comprehensive income	918	14	932
Stock-based compensation	159	0	159
Stock options exercised, including tax effects	51	0	51
Release of vested restricted stock units (RSUs), including tax effects	(83)	0	(83)
Conversion of convertible notes	29	0	29
Repurchases of common stock	(34)	0	(34)
Cash dividends declared	(3,289)	0	(3,289)
Equity at February 17, 2013	$ 10,112	$ 171	$ 10,283

	Attributable to Costco	Noncontrolling Interests	Total Equity
Equity at August 28, 2011	$ 12,002	$ 571	$ 12,573
Comprehensive income:			
Net income	714	26	740
Foreign-currency translation adjustment and other, net	(67)	(10)	(77)
Comprehensive income	647	16	663
Stock-based compensation	134	0	134
Stock options exercised, including tax effects	49	0	49
Release of vested RSUs, including tax effects	(74)	0	(74)
Conversion of convertible notes	1	0	1
Repurchases of common stock	(318)	0	(318)
Cash dividends declared	(209)	0	(209)
Equity at February 12, 2012	$ 12,232	$ 587	$ 12,819

Note 6 Stock-Based Compensation Plans

In the second quarter of fiscal 2012, the Fifth Restated 2002 Stock Incentive Plan was amended following shareholder approval and is now referred to as the Sixth Restated 2002 Stock Incentive Plan (Sixth Plan). The Sixth Plan initially authorized the issuance of 16,000,000 shares (9,143,000 RSUs) of common stock for future grants in addition to shares authorized under the previous plan. Each RSU issued is counted as 1.75 shares toward the limit of shares available. The Company issues new shares

Table of Contents

Note 6 Stock-Based Compensation Plans (Continued)

of common stock upon exercise of stock options and vesting of RSUs. RSUs are settled in shares and delivered to participants annually, net of shares equal to the minimum statutory withholding taxes.

As required by the Company s Sixth Plan, in conjunction with the special cash dividend discussed in Note 5, adjustments were made to awards outstanding on the dividend record date to preserve their value following the special cash dividend, as follows: (i) the number of shares subject to outstanding RSUs was increased; and (ii) the exercise prices of outstanding stock options were reduced and the number of shares subject to such options was increased. The number of outstanding stock options and RSUs was increased by multiplying the number of outstanding shares by a factor of 1.0763, representing the ratio of the NASDAQ closing price of $105.95 on December 5, 2012, which was the last trading day immediately prior to the ex-dividend date, to the NASDAQ opening price of $98.44 on the ex-dividend date, December 6, 2012. The exercise prices of stock options were reduced by multiplying the prices by a factor of 0.9291, representing the ratio of the NASDAQ opening price on the ex-dividend date to the NASDAQ closing price on December 5. Approximately 2,905,000 stock options were adjusted, and approximately 9,676,000 RSUs were adjusted. These adjustments did not result in additional share-based compensation expense, as the fair value of the outstanding awards immediately following the payment of the special cash dividend was equal to the fair value immediately prior to such distribution. As further required by the Sixth Plan, the maximum number of shares issuable under the Sixth Plan was proportionally adjusted based on the 1.0763 ratio described above. This resulted in an additional 778,000 shares available to be granted.

Summary of Stock Option Activity

All outstanding stock options were fully vested and exercisable as of February 17, 2013 and September 2, 2012. The following table summarizes stock option transactions during the first half of 2013:

	Number Of Options (in 000 s)	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value[1]
Outstanding at September 2, 2012	3,161	$ 40.90		
Exercised	(1,008)	35.75		
Special cash dividend	221	N/A		
Outstanding at February 17, 2013	2,374	$ 39.27	1.84	$ 149

(1) The difference between the exercise price and market value of common stock at February 17, 2013.

The tax benefits realized, derived from the compensation deductions resulting from option exercises, and intrinsic value related to total stock options exercised during the first half of 2013 and 2012 are provided in the following table:

	24 Weeks Ended	
	February 17, 2013	February 12, 2012
Actual tax benefit realized for stock options exercised	$ 23	$ 15
Intrinsic value of stock options exercised [1]	$ 64	$ 42

(1) The difference between the exercise price and market value of common stock measured at each individual exercise date.

14

Table of Contents

Note 6 Stock-Based Compensation Plans (Continued)

Summary of Restricted Stock Unit Activity

At February 17, 2013, 11,059,000 shares were available to be granted as RSUs under the Sixth Plan.

The following awards were outstanding at the end of the first half of 2013:

- 9,539,000 time-based RSUs that vest upon continued employment over specified periods of time;
- 408,000 performance-based RSUs granted to certain executive officers of the Company for which the performance targets have been met. Further restrictions lapse upon achievement of continued employment over specified periods of time; and
- 350,000 performance-based RSUs to be granted to executive officers of the Company upon achievement of specified performance targets for fiscal 2013, as determined by the Compensation Committee of the Board of Directors after the end of the fiscal year. These awards are included in the table below and the Company recognized compensation expense for these awards as it is currently deemed probable that the performance targets will be achieved.

The following table summarizes RSU transactions during the first half of 2013:

	Number of Units (in 000 s)	Weighted-Average Grant Date Fair Value
Non-vested at September 2, 2012	9,260	$ 66.14
Granted	4,192	90.99
Vested and delivered	(3,759)	67.34
Forfeited	(128)	74.05
Special cash dividend	732	N/A
Non-vested at February 17, 2013	10,297	$ 73.26

The remaining unrecognized compensation cost related to non-vested RSUs at Februray 17, 2013, was $638 and the weighted-average period of time over which this cost will be recognized is 1.85 years.

Summary of Stock-Based Compensation

The following table summarizes stock-based compensation expense and the related tax benefits under the Company s plans:

	12 Weeks Ended		24 Weeks Ended	
	February 17, 2013	February 12, 2012	February 17, 2013	February 12, 2012
Total stock-based compensation expense before income taxes	$ 66	$ 58	$ 159	$ 134
Less recognized income tax benefit	(22)	(19)	(53)	(44)

Total stock-based compensation expense, net of income taxes	$ 44	$ 39	$ 106	$ 90

Note 7 Income Taxes

The Company s reported effective income tax rates for the twelve and twenty-four weeks ended February 17, 2013, were 25.1% and 29.6%, respectively, compared to 34.2% and 37.3% for the twelve and twenty-four weeks ended February 12, 2012, respectively, in the accompanying condensed con-

Table of Contents

Note 7 Income Taxes (Continued)

solidated statements of income, which includes the net impact of discrete tax items. The Company s current year effective tax rate was favorably impacted by discrete tax benefits of $72, primarily due to a $62 tax benefit in connection with the special cash dividend of $7 per share paid by the Company to employees, who through the Company s 401(k) Retirement Plan, owned 22,600,000 shares of Company stock, through an Employee Stock Ownership Plan. Dividends paid on these shares are deductible for U.S. income tax purposes.

The Company s effective tax rate for the first half of 2012 was adversely impacted by a net discrete expense of $26 relating primarily to the adverse impact of an audit of Costco Mexico by the Mexican tax authority and the tax effects of nondeductible expenses for the Company s contributions to an initiative reforming alcohol beverage laws in Washington State.

Note 8 Net Income Per Common and Common Equivalent Share

The following table shows the amounts used in computing net income per share and the effect on net income and the weighted average number of shares of potentially dilutive common shares outstanding (shares in 000 s):

	12 Weeks Ended		24 Weeks Ended	
	February 17, 2013	February 12, 2012	February 17, 2013	February 12, 2012
Net income available to common stockholders used in basic and diluted net income per common share	$ 547	$ 394	$ 963	$ 714
Weighted average number of common shares used in basic net income per common share	435,975	434,535	434,698	434,374
RSUs and stock options	3,775	4,094	4,086	4,801
Conversion of convertible notes	62	839	438	861
Weighted average number of common shares and dilutive potential of common stock used in diluted net income per share	439,812	439,468	439,222	440,036
Anti-dilutive RSUs	0	6	0	4

Note 9 Commitments and Contingencies

Legal Proceedings

The Company is involved in a number of claims, proceedings and litigation arising from its business and property ownership. In accordance with applicable accounting guidance, the Company establishes an accrual for legal proceedings if and when those matters reach a stage where they present loss contingencies that are both probable and reasonably estimable. In such cases, there may be a possible exposure to loss in excess of any amounts accrued. The Company monitors those matters for developments that would affect the likelihood of a loss and the accrued amount, if any, thereof, and adjusts the amount as appropriate. If the loss contingency at issue is not both probable and reasonably estimable, the Company does not establish an accrual, but will continue to monitor the matter for developments that will make the loss contingency both probable and reasonably estimable. As of the date of this report, the Company has not recorded an accrual with respect to any matter described below. In each case, there is a reasonable possibility that a loss may be incurred. The possible loss or range of loss cannot in our view, however, be reasonably estimated because, among other things, (i) the remedies or penalties sought are indeterminate or unspecified; (ii) the legal and/or factual theories are not well developed; and/or (iii) the matters involve complex or novel legal theories or a large number of parties.

Table of Contents

Note 9 Commitments and Contingencies (Continued)

The Company is a defendant in the following matters, among others:

A case brought as a class action on behalf of certain present and former female managers, in which plaintiffs allege denial of promotion based on gender in violation of Title VII of the Civil Rights Act of 1964 and California state law. Shirley Rae Ellis v. Costco Wholesale Corp., United States District Court (San Francisco), Case No. C-04-3341-MHP. Plaintiffs seek compensatory damages, punitive damages, injunctive relief, interest and attorneys fees. Class certification was granted by the district court on January 11, 2007. On September 16, 2011, the United States Court of Appeals for the Ninth Circuit reversed the order of class certification and remanded to the district court for further proceedings. On September 25, 2012, the district court certified a class of women in the United States denied promotion to warehouse general manager or assistant general manager since January 3, 2002. Currently the class is believed to be approximately 1,250 people. A trial has been set for January 2014.

Numerous putative class actions have been brought around the United States against motor fuel retailers, including the Company, alleging that they have been overcharging consumers by selling gasoline or diesel that is warmer than 60 degrees without adjusting the volume sold to compensate for heat-related expansion or disclosing the effect of such expansion on the energy equivalent received by the consumer. The Company is named in the following actions: Raphael Sagalyn, et al., v. Chevron USA, Inc., et al., Case No. 07-430 (D. Md.); Phyllis Lerner, et al., v. Costco Wholesale Corporation, et al., Case No. 07-1216 (C.D. Cal.); Linda A. Williams, et al., v. BP Corporation North America, Inc., et al., Case No. 07-179 (M.D. Ala.); James Graham, et al. v. Chevron USA, Inc., et al., Civil Action No. 07-193 (E.D. Va.); Betty A. Delgado, et al., v. Allsups, Convenience Stores, Inc., et al., Case No. 07-202 (D.N.M.); Gary Kohut, et al. v. Chevron USA, Inc., et al., Case No. 07-285 (D. Nev.); Mark Rushing, et al., v. Alon USA, Inc., et al., Case No. 06-7621 (N.D. Cal.); James Vanderbilt, et al., v. BP Corporation North America, Inc., et al., Case No. 06-1052 (W.D. Mo.); Zachary Wilson, et al., v. Ampride, Inc., et al., Case No. 06-2582 (D. Kan.); Diane Foster, et al., v. BP North America Petroleum, Inc., et al., Case No. 07-02059 (W.D. Tenn.); Mara Redstone, et al., v. Chevron USA, Inc., et al., Case No. 07-20751 (S.D. Fla.); Fred Aguirre, et al. v. BP West Coast Products LLC, et al., Case No. 07-1534 (N.D. Cal.); J.C. Wash, et al., v. Chevron USA, Inc., et al.; Case No. 4:07cv37 (E.D. Mo.); Jonathan Charles Conlin, et al., v. Chevron USA, Inc., et al.; Case No. 07 0317 (M.D. Tenn.); William Barker, et al. v. Chevron USA, Inc., et al.; Case No. 07-cv-00293 (D.N.M.); Melissa J. Couch, et al. v. BP Products North America, Inc., et al., Case No. 07cv291 (E.D. Tex.); S. Garrett Cook, Jr., et al., v. Hess Corporation, et al., Case No. 07cv750 (M.D. Ala.); Jeff Jenkins, et al. v. Amoco Oil Company, et al., Case No. 07-cv-00661 (D. Utah); and Mark Wyatt, et al., v. B. P. America Corp., et al., Case No. 07-1754 (S.D. Cal.). On June 18, 2007, the Judicial Panel on Multidistrict Litigation assigned the action, entitled In re Motor Fuel Temperature Sales Practices Litigation, MDL Docket No 1840, to Judge Kathryn Vratil in the United States District Court for the District of Kansas. On April 12, 2009, the Company agreed to settle the actions in which it is named as a defendant. Under the settlement, the Company agreed, to the extent allowed by law, to install over five years from the effective date of the settlement temperature-correcting dispensers in the States of Alabama, Arizona, California, Florida, Georgia, Kentucky, Nevada, New Mexico, North Carolina, South Carolina, Tennessee, Texas, Utah, and Virginia. Other than payments to class representatives, the settlement does not provide for cash payments to class members. On September 22, 2011, the court preliminarily approved a revised settlement, which did not materially alter the terms. On April 24, 2012, the court granted final approval of the revised settlement. A class member who objected has filed a notice of appeal from the order approving the settlement. Plaintiffs have moved for an award of $10 million in attorneys fees, as well as an award of costs and payments to class representatives. The Company has opposed the motion.

On October 4, 2006, the Company received a grand jury subpoena from the United States Attorney s Office for the Central District of California, seeking records relating to the Company s receipt and handling of hazardous merchandise returned by Costco members and other records. The Company has entered into a tolling agreement with the United States Attorney s Office.

Table of Contents

Note 9 Commitments and Contingencies (Continued)

The Environmental Protection Agency (EPA) issued an Information Request to the Company, dated November 1, 2007, regarding warehouses in the states of Arizona, California, Hawaii, and Nevada and relating to compliance with regulations concerning air-conditioning and refrigeration equipment. On March 4, 2009, the Company was advised by the Department of Justice that the Department was prepared to allege that the Company has committed at least nineteen violations of the leak-repair requirements of 40 C.F.R. § 82.156(i) and at least seventy-four violations of the recordkeeping requirements of 40 C.F.R. § 82.166(k), (m) at warehouses in these states. The Company has responded to these allegations, is engaged in communications with the Department about these and additional allegations, and has entered into tolling agreements. Substantial penalties may be levied for violations of the Clean Air Act. The Company is cooperating with this inquiry.

On October 7, 2009, the District Attorneys for San Diego, San Joaquin and Solano Counties filed a complaint, People of the State of California v. Costco Wholesale Corp., et al, No. 37-2009-00099912 (Superior Court for the County of San Diego), alleging on information and belief that the Company has violated and continues to violate provisions of the California Health and Safety Code and the Business and Professions Code through the use of certain spill clean-up materials at its gasoline stations. Relief sought includes, among other things, requests for preliminary and permanent injunctive relief, civil penalties, costs and attorneys fees.

The Company has received notices from most states stating that they have appointed an agent to conduct an examination of the books and records of the Company to determine whether it has complied with state unclaimed property laws. In addition to seeking the turnover of unclaimed property subject to escheat laws, the states may seek interest, penalties, costs of examinations, and other relief.

The Company does not believe that any pending claim, proceeding or litigation, either alone or in the aggregate, will have a material adverse effect on the Company s financial position; however, it is possible that an unfavorable outcome of some or all of the matters, however unlikely, could result in a charge that might be material to the results of an individual fiscal quarter.

Table of Contents

Note 10 Segment Reporting

The Company and its subsidiaries are principally engaged in the operation of membership warehouses in the U.S., Canada, Mexico, the United Kingdom, Japan, Australia, and through majority-owned subsidiaries in Taiwan and Korea. The Company s reportable segments are largely based on management s organization of the operating segments for operational decisions and assessments of financial performance, which considers geographic locations. The material accounting policies of the segments are the same as described in the notes to the consolidated financial statements included in the Company s annual report filed on Form 10-K for the fiscal year ended September 2, 2012, and Note 1 above. All material inter-segment net sales and expenses have been eliminated in computing total revenue and operating income. Certain operating expenses, predominantly stock-based compensation, are incurred on behalf of the Company s Canadian and Other International Operations, but are included in the U.S. Operations because those costs are not allocated internally and generally come under the responsibility of the Company s U.S. management team.

	United States Operations	Canadian Operations	Other International Operations	Total
Twelve Weeks Ended February 17, 2013				
Total revenue	$ 17,794	$ 4,002	$ 3,075	$ 24,871
Operating income	453	156	129	738
Depreciation and amortization	160	28	29	217
Additions to property and equipment	205	37	213	455
Twelve Weeks Ended February 12, 2012				
Total revenue	$ 16,611	$ 3,562	$ 2,794	$ 22,967
Operating income	373	144	127	644
Depreciation and amortization	156	28	25	209
Additions to property and equipment	207	33	49	289
Twenty-Four Weeks Ended February 17, 2013				
Total revenue	$ 34,712	$ 7,891	$5,983	$ 48,586
Operating income	796	332	249	1,377
Depreciation and amortization	315	56	59	430
Additions to property and equipment	510	92	341	943
Net property and equipment	9,422	1,665	2,299	13,386
Total assets	20,105	4,301	4,683	29,089
Twenty-Four Weeks Ended February 12, 2012				
Total revenue	$ 32,225	$ 7,003		