COSTCO WHOLESALE CORP /NEW
Form 10-K
October 16, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K

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

For the fiscal year ended September 1, 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 incorporation or organization)	(I.R.S. Employer Identification No.)

999 Lake Drive, Issaquah, WA 98027
(Address of principal executive offices) (Zip Code)
Registrant's telephone number, including area code: (425) 313-8100
Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, $.005 Par Value	The NASDAQ Global Select Market

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES ý NO o
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES o NO ý
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 ý NO o
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 (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES ý NO o
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o
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 the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

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

The aggregate market value of the voting stock held by non-affiliates of the registrant as of February 17, 2013 was $44,218,428,626

The number of shares outstanding of the registrant’s common stock as of October 9, 2013 was 436,922,037

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Company’s Proxy Statement for the Annual Meeting of Shareholders to be held on January 30, 2014, are incorporated by reference into Part III of this Form 10-K.

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COSTCO WHOLESALE CORPORATION
ANNUAL REPORT ON FORM 10-K FOR THE FISCAL YEAR ENDED SEPTEMBER 1, 2013
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INFORMATION RELATING TO FORWARD LOOKING STATEMENTS

Certain statements contained in this Report constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, and Section 21E of the Securities Exchange Act of 1934. They include statements that address activities, events, conditions or developments that we expect or anticipate may occur in the future and may relate to such matters as sales growth, increases in comparable store sales, cannibalization of existing locations by new openings, price or fee changes, earnings performance, earnings per share, stock-based compensation expense, warehouse openings and closures, the amount we expect to spend on our expansion plans, the effect of adopting certain accounting standards, future financial reporting, financing, margins, return on invested capital, strategic direction, expense controls, membership renewal rates, shopping frequency, litigation impact and the demand for our products and services. Forward-looking statements may also be identified by the words “believe,” “project,” “expect,” “anticipate,” “estimate,” “intend,” “strategy,” “future,” “opportu “may,” “should,” “will,” “would,” “will be,” “will continue,” “will likely result,” and similar expressions. Such forward-lookin statements involve risks and uncertainties that may cause actual events, results, or performance to differ materially from those indicated by such statements, including, without limitation, the factors set forth in the section titled “Item 1A-Risk Factors”, and other factors noted in the section titled “Item 7-Management's Discussion and Analysis of Financial Condition and Results of Operations” and in the consolidated financial statements and related notes in Item 8 of this Report. Forward-looking statements speak only as of the date they are made, and we do not undertake to update these forward-looking statements, except as required by law.

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PART I

Item 1—Business

Costco Wholesale Corporation and its subsidiaries (Costco or the Company) began operations in 1983 in Seattle, Washington. We are principally engaged in the operation of membership warehouses in the United States (U.S.) and Puerto Rico, Canada, the United Kingdom (U.K.), Mexico, Japan, Australia, and through majority-owned subsidiaries in Taiwan and Korea. Our common stock trades on the NASDAQ Global Select Market under the symbol “COST.”

In 2011 and prior to the July 2012 acquisition of the 50% noncontrolling interest in our joint venture in Mexico, the financial position and results of Mexico's operations were consolidated, and the joint venture partner's share was included in "net income attributable to noncontrolling interests" in the consolidated statements of income. Subsequent to the acquisition, we have included 100% of Mexico's operations within "net income attributable to Costco" in the consolidated statements of income.

We report on a 52/53-week fiscal year, consisting of thirteen, four-week periods and ending on the Sunday nearest the end of August. The first three quarters consist of three periods each, and the fourth quarter consists of four periods (five weeks in the thirteenth period in a 53-week year). The material seasonal impact in our operations is an increased level of net sales and earnings during the winter holiday season. References to 2013 and 2011 relate to the 52-week fiscal years ended September 1, 2013 and August 28, 2011, respectively. References to 2012 relate to the 53-week fiscal year ended September 2, 2012.

General

We operate membership warehouses based on the concept that offering our 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. This turnover, when combined with the operating efficiencies achieved by volume purchasing, efficient distribution and reduced handling of merchandise in no-frills, self-service warehouse facilities, enables us to operate profitably at significantly lower gross margins than traditional wholesalers, mass merchandisers, supermarkets, and supercenters.

We buy the majority of our merchandise directly from manufacturers and route it to a cross-docking consolidation point (depot) or directly to our warehouses. Our depots receive container-based shipments from manufacturers and reallocate these goods for shipment to our individual warehouses, generally in less than twenty-four hours. This process maximizes freight volume and handling efficiencies, eliminating many of the costs associated with traditional multiple-step distribution channels. Such traditional steps include purchasing from distributors as opposed to manufacturers, use of central receiving, storing and distributing warehouses, and storage of merchandise in locations off the sales floor.

Because of our high sales volume and rapid inventory turnover, we generally sell inventory before we are required to pay many of our merchandise vendors, even though we take advantage of early payment discounts when available. To the extent that sales increase and inventory turnover becomes more rapid, a greater percentage of inventory is financed through payment terms provided by suppliers rather than by our working capital.

Our typical warehouse format averages approximately 143,000 square feet; newer units tend to be slightly larger. Floor plans are designed for economy and efficiency in the use of selling space, the handling of merchandise, and the control of inventory. Because shoppers are attracted principally by the quality of merchandise and the availability of low prices, our warehouses are not elaborate facilities. By strictly controlling the entrances and exits of our warehouses and using a membership format, we have limited inventory losses (shrinkage) to amounts well below those of typical discount retail operations.

Marketing and promotional activities generally relate to new warehouse openings, occasional direct mail to prospective new members, and regular direct marketing programs (such as The Costco Connection, a magazine we publish for our members, coupon mailers, emails from costco.com, costco.ca, and costco.co.uk, and handouts) to existing members promoting selected merchandise.

Our warehouses generally operate on a seven-day, 69-hour week, open weekdays between 10:00 a.m. and 8:30 p.m., with earlier weekend closing hours. Gasoline operations generally have extended hours. Because the hours of operation are shorter than those of traditional retailers, discount retailers and supermarkets, and due to other efficiencies inherent in a warehouse-type operation, labor costs are lower relative to the volume of sales. Merchandise

is generally stored on racks above the sales floor and displayed on pallets containing large quantities, thereby reducing labor required for handling and stocking.
Our strategy is to provide our members with a broad range of high quality merchandise at prices consistently lower than they can obtain elsewhere. We seek to limit specific items in each product line to fast-selling models, sizes, and colors. Therefore,

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Item 1—Business (Continued)

we carry an average of approximately 3,700 active stock keeping units (SKUs) per warehouse in our core warehouse business, as opposed to a significantly higher number of SKUs at discount retailers, supermarkets, and supercenters. Many consumable products are offered for sale in case, carton, or multiple-pack quantities only.
In keeping with our policy of member satisfaction, we generally accept returns of merchandise. On certain electronic items, we typically have a 90-day return policy and provide, free of charge, technical support services, as well as an extended warranty. Additional third-party warranty coverage is sold on certain electronic item purchases.
The following table indicates the approximate percentage of annual net sales accounted for by major category of items:

	2013	2012	2011
Sundries (including candy, snack foods, tobacco, alcoholic and nonalcoholic beverages and cleaning and institutional supplies)	22 %	22 %	22 %
Hardlines (including major appliances, electronics, health and beauty aids, hardware, office supplies, cameras, garden and patio, sporting goods, toys, seasonal items and automotive supplies)	16 %	16 %	17 %
Food (including dry and institutionally packaged foods)	21 %	21 %	21 %
Softlines (including apparel, domestics, jewelry, housewares, media, home furnishings and small appliances)	11 %	10 %	10 %
Fresh Food (including meat, bakery, deli and produce)	13 %	13 %	12 %
Ancillary and Other (including gas stations, pharmacy, food court, optical, one-hour photo, hearing aid and travel)	17 %	18 %	18 %

Ancillary businesses within or next to our warehouses provide expanded products and services and encourage members to shop more frequently. The following table indicates the number of ancillary businesses in operation at fiscal year-end:

	2013	2012	2011
Food Court	628	602	586
One-Hour Photo Centers	622	591	581
Optical Dispensing Centers	614	589	574
Pharmacies	565	544	529
Hearing-Aid Centers	502	469	427
Gas Stations	414	394	368
Number of warehouses	634	608	592

Our online business, which operates websites in the U.S., Canada, and the U.K., provide our members additional products, many not found in our warehouses. These products vary by country and include services such as photo center, pharmacy, travel, business delivery, and membership services. Net sales for our online business were approximately 3% of our consolidated net sales.
In general and depending on the country, our warehouses accept cash, checks, certain debit cards, American Express, or a private label Costco credit card. Losses associated with dishonored checks have been minimal, as members who have issued dishonored checks are identified and prevented from making further purchases until restitution is made.
We have direct buying relationships with many producers of national brand-name merchandise. We do not obtain a significant portion of merchandise from any one supplier. We have not experienced any difficulty in obtaining sufficient quantities of merchandise, and believe that if one or more of our current sources of supply became unavailable, we would be able to obtain alternative sources without substantial disruption of our business. We also purchase private label merchandise, as long as quality and customer demand are comparable and the value to our

members is greater as compared to brand-name items.
Certain financial information for our segments and geographic areas is included in Note 12 to the consolidated financial statements included in Item 8 of this Report.

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Item 1—Business (Continued)

Membership

Our membership format is designed to reinforce member loyalty and provide continuing fee revenue. Members can utilize their membership at any Costco warehouse location in any country. We have two types of members: Business and Gold Star (individual). Business membership is limited to businesses, including individuals with a business license, retail sales license or other evidence of business existence. Business members pay an annual membership fee of approximately $55 for the primary cardholder, and have the ability to add additional cardholders (add-ons) for an annual fee of approximately $55 each. Gold Star memberships are also available for an annual fee of approximately $55 to individuals who may not qualify for a Business membership, however add-ons are not available for Gold Star memberships. All paid memberships include a free household card.

Our member renewal rate was approximately 90% in the U.S. and Canada, and approximately 86% on a worldwide basis in 2013. The renewal rate is a trailing calculation that captures renewals during the period seven to eighteen months prior to the reporting date.

Our membership was made up of the following (in thousands):

	2013	2012	2011
Gold Star	28,900	26,700	25,000
Business	6,600	6,400	6,300
Business, add-on	3,500	3,800	4,000
Total paid cardholders	39,000	36,900	35,300
Additional cardholders	32,200	30,100	28,700
Total cardholders	71,200	67,000	64,000

All members are eligible for an Executive membership, with the exception of Business add-on members, in the U.S., Canada, Mexico, and the United Kingdom, for an annual fee of approximately $110. Executive members qualify for a 2% annual reward (which can be redeemed at Costco warehouses), up to a maximum of approximately $750 per year, on qualified purchases. This program also offers (except in Mexico) additional savings and benefits on various business and consumer services, such as check printing services, the Costco auto purchase program, auto and home insurance, online investing and identity protection. The services are generally provided by third-parties and vary by country and state. At the end of 2013, 2012, and 2011, Executive members represented 38% of eligible cardholders. Executive members generally spend more than other members, and the percentage of our net sales attributable to these members continues to increase.

Effective November 1, 2011, for new members, and January 1, 2012, for renewing members, we increased our annual membership fee in the U.S. and Canada. Please refer to Management's Discussion and Analysis in Item 7 of this Report for further explanation of the change and its impact.

Labor

Our employee count approximated:

	2013	2012	2011
Full-time employees	103,000	96,000	92,000
Part-time employees	81,000	78,000	72,000
Total employees	184,000	174,000	164,000

Approximately 13,800 hourly employees in certain of our locations in five states are represented by the International Brotherhood of Teamsters. All remaining employees are non-union. We consider our employee relations to be very good.

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Item 1—Business (Continued)

Competition

Our industry is highly competitive, based on factors such as price, merchandise quality and selection, warehouse location and member service. We compete with over 800 warehouse club locations across the U.S. and Canada (primarily Wal-Mart's Sam's Club and BJ's Wholesale Club), and every major metropolitan area has multiple club operations. In addition, we compete with a wide range of global, national and regional wholesalers and retailers, including supermarkets, supercenter stores, department and specialty stores, gasoline stations, and internet-based retailers. Competitors such as Wal-Mart, Target, Kohl's and Amazon.com are among our significant general merchandise retail competitors. We also compete with operators selling a single category or narrow range of merchandise, such as Lowe's, Home Depot, Office Depot, PetSmart, Staples, Kroger, Trader Joe's, Whole Foods, CVS, Walgreens and Best Buy. Our international operations face similar competition.

Intellectual Property

We believe that, to varying degrees, our trademarks, trade names, copyrights, proprietary processes, trade secrets, patents, trade dress, domain names and similar intellectual property add significant value to our business and are important factors in our success. We have invested significantly in the development and protection of our well-recognized brands, including the Costco Wholesale® series of trademarks and our private label brand, Kirkland Signature®. We believe that Kirkland Signature products are premium products offered to our members at prices that are generally lower than those for national brand products and that they help lower costs, differentiate our merchandise offerings from other retailers, and generally earn higher margins. We expect to increase the sales penetration of our private label items in the future.

We rely on trademark and copyright laws, trade secret protection, and confidentiality and license agreements with our suppliers, employees and others to protect our proprietary rights. The availability and duration of trademark registrations vary from country to country; however, trademarks are generally valid and may be renewed indefinitely as long as they are in use and their registrations are properly maintained.

Available Information

Our internet website is www.costco.com. We make available through the Investor Relations section of that site, free of charge, our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, Proxy Statements and Forms 3, 4 and 5, and any amendments to those reports, as soon as reasonably practicable after filing such materials with, or furnishing such documents to, the Securities and Exchange Commission (SEC). The information found on our website is not part of this or any other report filed with or furnished to the SEC. In addition, the public may read and copy any materials we file with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains an internet site that contains reports, proxy and information statements, and other information regarding issuers, such as the Company, that file electronically with the SEC at www.sec.gov.

We have adopted a code of ethics for senior financial officers pursuant to Section 406 of the Sarbanes-Oxley Act. Copies of the code are available free of charge by writing to Secretary, Costco Wholesale Corporation, 999 Lake Drive, Issaquah, WA 98027. If the Company makes any amendments to this code (other than technical, administrative, or non-substantive amendments) or grants any waivers, including implicit waivers, from this code to the CEO, chief financial officer or controller, we will disclose (on our website or in a Form 8-K report filed with the SEC) the nature of the amendment or waiver, its effective date, and to whom it applies.

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Item 1—Business (Continued)

Executive Officers of the Registrant

The executive officers of Costco, their position, and ages are listed below. All executive officers have 25 or more years of service with the Company.

Name	Position	Executive Officer Since	Age
W. Craig Jelinek	President and Chief Executive Officer. Mr. Jelinek has been President and Chief Executive Officer since January 2012 and has been a director since February 2010. He was President and Chief Operating Officer from February 2010 to December 2011. Prior to that he was Executive Vice President, Chief Operating Officer, Merchandising since 2004.	1995	61
Jeffrey H. Brotman	Chairman of the Board. Mr. Brotman is a co-founder of Costco and has been a director since its inception.	1983	71
Richard A. Galanti	Executive Vice President and Chief Financial Officer. Mr. Galanti has been a director since January 1995.	1993	57
Franz Lazarus	Executive Vice President, Administration. Mr. Lazarus was Senior Vice President, Administration-Global Operations since 2006.	2012	66
John McKay	Executive Vice President, Chief Operating Officer, Northern Division. Mr. McKay was Senior Vice President, General Manager, Northwest Region from 2000 to March 2010.	2010	56
Paul G. Moulton	Executive Vice President, Chief Information Officer. Mr. Moulton was Executive Vice President, Real Estate Development until March 2010.	2001	62
James P. Murphy	Executive Vice President, International. Mr. Murphy was Senior Vice President, International, from September 2004 to October 2010.	2011	60
Joseph P. Portera	Executive Vice President, Chief Operating Officer, Eastern and Canadian Divisions. Chief Diversity Officer since 2010.	1994	61
Timothy L. Rose	Executive Vice President, Ancillary Businesses, Manufacturing, and Business Centers. Mr. Rose was Senior Vice President, Merchandising, Food and Sundries and Private Label from 1995 to December 2012.	2013	61
Douglas W. Schutt	Executive Vice President, Chief Operating Officer, Merchandising. Mr. Schutt was Executive Vice President, Chief Operating Officer, Northern Division and Midwest Region from 2004 to March 2010.	2004	54
Thomas K. Walker	Executive Vice President, Construction and Distribution. Mr. Walker retired as of September 2013.	2004	73
Dennis R. Zook	Executive Vice President, Chief Operating Officer, Southwest Division and Mexico.	1993	64

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Item 1A—Risk Factors

The risks described below could materially and adversely affect our business, financial condition and results of operations. These risks are not the only risks that we face. We could also be affected by additional factors that apply to all companies operating in the U.S. and globally, as well as other risks that are not presently known to us or that we currently consider to be immaterial. You should review these Risk Factors carefully in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 7 and our consolidated financial statements and related notes in Item 8 of this Report.

Business and Operating Risks

We are highly dependent on the financial performance of our U.S. and Canadian operations.

Our financial and operational performance is highly dependent on our U.S. and Canadian operations, which comprised 88% and 84% of consolidated net sales and operating income in 2013, respectively. Within the U.S., we are highly dependent on our California operations, which comprised 23% of consolidated net sales in 2013. Our California market, in general, has a larger percentage of higher volume warehouses as compared to our other markets. Any substantial slowing or sustained decline in these operations could materially adversely affect our business and financial results. Declines in financial performance of our U.S. operations, particularly in California, and our Canadian operations could arise from, among other things: failing to meet targets for warehouse openings; declines in actual or estimated comparable warehouse sales growth rates and expectations; negative trends in operating expenses, including increased labor, healthcare and energy costs; cannibalizing existing locations with new warehouses; shifts in sales mix toward lower gross margin products; changes or uncertainties in economic conditions in our markets, including higher levels of unemployment and depressed home values; and failing to consistently provide high quality products and innovative new products to retain our existing member base and attract new members.

We may be unsuccessful implementing our growth strategy, including expanding our business, both in existing markets and in new markets, which could have an adverse impact on our business, financial condition and results of operations.

Our future growth is dependent, in part, on our ability to acquire property, and build or lease new warehouses. We compete with other retailers and businesses for suitable locations. Local land use and other regulations restricting the construction and operation of our warehouses, as well as local community actions opposed to the location of our warehouses at specific sites and the adoption of local laws restricting our operations and environmental regulations may impact our ability to find suitable locations, and increase the cost of constructing, leasing and operating our warehouses. We also may have difficulty negotiating leases or real estate purchase agreements on acceptable terms. In addition, certain jurisdictions have enacted or proposed laws and regulations that would prevent or restrict the operation or expansion plans of certain large retailers and warehouse clubs, including us, within their jurisdictions. Failure to manage these and other similar factors effectively may affect our ability to timely build or lease new warehouses, which could have a material adverse effect on our future growth and profitability.

We seek to expand our business in existing markets in order to attain a greater overall market share. Because our warehouses typically draw members from their local areas, a new warehouse may draw members away from our existing warehouses and adversely affect comparable warehouse sales performance and member traffic at those existing warehouses.

We also intend to open warehouses in new markets. The risks associated with entering a new market include difficulties in attracting members due to a lack of familiarity with us, attracting members of other wholesale club operators currently operating in the new market, our lack of familiarity with local member preferences, and seasonal differences in the market. In addition, entry into new markets may bring us into competition with new competitors or with existing competitors with a large, established market presence. In new markets, we cannot ensure that our new warehouses will be profitably deployed and, as a result, our future profitability could be delayed or otherwise materially adversely affected.

Our failure to maintain positive membership loyalty and brand recognition could adversely affect our results of operations.

Membership loyalty is essential to our business model. Damage to our brands or reputation may negatively impact comparable warehouse sales, lower employee morale and productivity, diminish member trust, and reduce member renewal rates and, accordingly, membership fee revenues, resulting in a reduction in shareholder value.

In addition, we sell many products under our owned and exclusive Kirkland Signature brand. Maintaining consistent product quality, competitive pricing, and availability of our Kirkland Signature products for our customers is essential to developing and

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Item 1A—Risk Factors (Continued)

maintaining customer loyalty. These products also generally carry higher margins than national brand products and represent a growing portion of our overall sales. If the Kirkland Signature brand experiences a loss of consumer acceptance or confidence, our sales and gross margin results could be adversely affected.

Disruptions in our depot operations could adversely affect sales and member satisfaction.

We depend on the orderly operation of the merchandise receiving and distribution process, primarily through our depots. Although we believe that our receiving and distribution process is efficient, unforeseen disruptions in operations due to fires, hurricanes, earthquakes or other catastrophic events, labor shortages or shipping problems, may result in delays in the delivery of merchandise to our warehouses, which could adversely affect sales and the satisfaction of our members.

We rely extensively on computer systems to process transactions, summarize results and manage our business. Failure to adequately update our systems and disruptions in both our primary and back-up systems could harm our ability to run our business and adversely affect our results of operations.

Although we believe that we have independent, redundant primary and secondary computer systems, given the number of individual transactions we have each year it is important that we maintain uninterrupted operation of our business-critical computer systems. Our computer systems, including our back-up systems, are subject to damage or interruption from power outages, computer and telecommunications failures, computer viruses, internal or external security breaches, catastrophic events such as fires, earthquakes, tornadoes and hurricanes, and errors by our employees. If our computer systems and our back-up systems are damaged or cease to function properly, we may have to make significant investments to fix or replace them, and we may suffer interruptions in our operations in the interim. Any material interruption in our computer systems could have a material adverse effect on our business or results of operations.

We are currently making, and will continue to make, significant technology investments to transform our information processes and systems that are key to managing our business. We must monitor and choose the right investments and implement them at the right pace. The risk of system disruption is increased when significant system changes are undertaken, although we believe that our change management process will mitigate this risk. Excessive technological change could impact the effectiveness of adoption, and could make it more difficult for us to realize benefits from the technology. Targeting the wrong opportunities, failing to make the best investments, or making an investment commitment significantly above or below our needs could result in the loss of our competitive position and adversely impact our financial condition or results of operations. Additionally, the potential problems and interruptions associated with implementing technology initiatives could disrupt or reduce the efficiency of our operations in the short term. These initiatives might not provide the anticipated benefits or may provide them on a delayed schedule or at a higher cost.

If we do not maintain the privacy and security of member-related and business information, we could damage our reputation with members, incur substantial additional costs and become subject to litigation.

We receive, retain, and transmit certain personal information about our members and entrust that information to third party business associates, including cloud service providers who perform these activities for us. Our online business, which operates websites in the U.S., Canada, and the U.K., depends upon the secure transmission of confidential information over public networks, including information permitting cashless payments. A compromise of our security systems or those of our business associates that results in our members' personal information being obtained by unauthorized persons could adversely affect our reputation with our members and others, as well as our operations, results of operations, financial condition and liquidity, and could result in litigation against us or the imposition of penalties. In addition, a security breach could require that we expend significant additional resources related to the security of information systems and could result in a disruption of our operations, particularly our online business. Additionally, the use of individually identifiable data by our business and our business associates is regulated at the national and local or state level in all of our operating countries. Privacy and information security laws and regulations change, and compliance with them may result in cost increases due to necessary systems changes and the development of new administrative processes. If we, or those with whom we share information, fail to comply with these laws and regulations or experience a data security breach, our reputation could be damaged, possibly resulting in lost future business, and we could be subjected to additional legal risk as a result of non-compliance.

Our security measures may be undermined due to the actions of outside parties, employee error, malfeasance, or otherwise, and, as a result, an unauthorized party may obtain access to our data systems and misappropriate business and personal information. Because the techniques used to obtain unauthorized access, disable or degrade service, or sabotage systems change frequently and may not immediately produce signs of intrusion, we may be unable to anticipate these techniques or

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Item 1A—Risk Factors (Continued)

to implement adequate preventative measures. Any such breach or unauthorized access could result in significant legal and financial exposure, damage to our reputation, and potentially have an adverse effect on our business.

We are subject to payment related risks.

We accept payments using a variety of methods, including cash and checks, various select credit and debit cards, and our proprietary cash card. As we offer new payment options to our members, we may be subject to additional rules, regulations, compliance requirements, and higher fraud losses. For certain payment methods, we pay interchange and other related card acceptance fees, along with additional transaction processing fees which may increase over time and raise our operating costs. We rely on third parties to provide payment transaction processing services, including the processing of credit and debit cards, and our proprietary cash card, and it could temporarily disrupt our business if these companies become unwilling or unable to provide these services to us. We are also subject to payment card association rules and network operating rules, including data security rules, certification requirements and rules governing electronic funds transfers, which could change over time. If we fail to comply with these rules or transaction processing requirements, we may not be able to accept certain payment methods. In addition, if our internal systems are breached or compromised, we may be liable for banks' compromised card re-issuance costs, subject to fines and higher transaction fees and lose our ability to accept credit and/or debit card payments from our members, and our business and operating results could be adversely affected.

We are subject to the risks of selling unsafe products which could result in illness or injury to our members, harm our reputation and subject us to litigation.

If our merchandise offerings, including food and prepared food products for human consumption, drugs, children's products, and pet products, do not meet or are perceived not to meet applicable safety standards or our members' expectations regarding safety, we could experience lost sales, increased costs and be exposed to legal and reputational risk. The sale of these items involves the risk of health-related illness or injury to our members. Such illnesses or injuries could result from tampering by unauthorized third parties, product contamination or spoilage, including the presence of foreign objects, substances, chemicals, other agents, or residues introduced during the growing, manufacturing, storage, handling and transportation phases. Our vendors are generally contractually required to comply with applicable product safety laws, and we are dependent on them to ensure that the products we buy comply with all safety standards. While we are subject to governmental inspection and regulations and work to comply in all material respects with applicable laws and regulations, we cannot be sure that consumption of our products will not cause a health-related illness or injury in the future or that we will not be subject to claims, lawsuits or government investigations relating to such matters resulting in costly product recalls and other liabilities that could adversely affect our business and results of operations. Even if a product liability claim is unsuccessful or is not fully pursued, the negative publicity surrounding any assertion that our products caused illness or injury could adversely affect our reputation with existing and potential members and our corporate and brand image and these effects could be long term.

If we do not successfully develop and maintain a relevant multichannel experience for our members, our results of operations could be adversely impacted.

Multichannel retailing is rapidly evolving and we must keep pace with changing member expectations and new developments by our competitors. Our members are increasingly using computers, tablets, mobile phones, and other devices to shop online. As part of our multichannel strategy, we are making technology investments in our websites and recently launched a mobile application for mobile phones and other electronic devices. If we are unable to make, improve, or develop relevant member-facing technology in a timely manner, our ability to compete and our results of operations could be adversely affected.

Our inability to attract, train and retain highly qualified employees could adversely impact our business, financial condition and results of operations.

Our success depends to a significant degree on the continued contributions of members of our senior management and other key operations, merchandising and administrative personnel, and the loss of any such person(s) could have a material adverse effect on our business. Other than an annual agreement with our CEO, Mr. Jelinek, we have no employment agreements with our officers. We must attract, train and retain a large and growing number of highly qualified employees, while controlling related labor costs and maintaining our core values. Our ability to control labor costs is subject to numerous external factors, including regulatory changes, prevailing wage rates, and healthcare and other insurance costs. We compete with other retail and non-retail businesses for these employees and invest significant resources in training and motivating them. There is no assurance that we will be able to attract or retain highly qualified employees in the future, which could have a material adverse effect on our business, financial condition and results of operations. We do not maintain key man insurance.

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Item 1A—Risk Factors (Continued)

Failure to meet market expectations for our financial performance could adversely affect the market price and volatility of our stock.
We believe that the price of our stock generally reflects high market expectations for our future operating results. Any failure to meet or delay in meeting these expectations, including our comparable warehouse sales growth rates, margins, earnings and earnings per share or new warehouse openings could cause the market price of our stock to decline, as could changes in our dividend or stock repurchase policies.

Market and Other External Risks
We face strong competition from other retailers and warehouse club operators, which could adversely affect our business, financial condition and results of operations.
The retail business is highly competitive. We compete for members, employees, sites, products and services and in other important respects with a wide range of local, regional and national wholesalers and retailers, both in the United States and in foreign countries, including other warehouse club operators, supermarkets, supercenter stores, department and specialty stores, gasoline stations, and internet-based retailers. Such retailers and warehouse club operators compete in a variety of ways, including merchandise pricing, selection and availability, services, location, convenience, and store hours. The evolution of retailing in online and mobile channels has improved the ability of members to comparison shop with digital tools, which has enhanced competition. Our inability to respond effectively to competitive pressures, changes in the retail markets and member expectations could result in lost market share and negatively affect our financial results. Some competitors may have greater financial resources, better access to merchandise and greater market penetration than we do.
General economic factors, domestically and internationally, may adversely affect our business, financial condition and results of operations.
Higher energy costs, inflation, levels of unemployment, healthcare costs, consumer debt levels, foreign currency exchange rates, unsettled financial markets, weaknesses in housing and real estate markets, reduced consumer confidence, changes related to government fiscal and tax policies, sovereign debt crises, and other economic factors could adversely affect demand for our products and services or require a change in the mix of products we sell. Prices of certain commodity products, including gasoline and other food products, are historically volatile and are subject to fluctuations arising from changes in domestic and international supply and demand, labor costs, competition, market speculation, government regulations, taxes and periodic delays in delivery. Rapid and significant changes in commodity prices may affect our sales and profit margins. These factors could also increase our merchandise costs and/or selling, general and administrative expenses, and otherwise adversely affect our operations and financial results. General economic conditions can also be affected by the outbreak of war, acts of terrorism, or other significant national or international events.
We may not timely identify or effectively respond to consumer trends, which could negatively affect our relationship with our members, the demand for our products and services, and our market share.
It is difficult to consistently and successfully predict the products and services our members will demand. Our success depends, in part, on our ability to identify and respond to trends in demographics and consumer preferences. Failure to timely identify or effectively respond to changing consumer tastes, preferences (including those relating to sustainability of product sources) and spending patterns could negatively affect our relationship with our members, the demand for our products and services and our market share. If we are not successful at predicting our sales trends and adjusting our purchases accordingly, we may have excess inventory, which could result in additional markdowns and reduce our operating performance. This could have an adverse effect on margins (net sales less merchandise costs) and operating income.
Vendors may be unable to supply us with quality merchandise at the right prices in a timely manner or may fail to adhere to our high standards resulting in adverse effects on our business, merchandise inventories, sales and profit margins.

We depend heavily on our ability to purchase merchandise in sufficient quantities at competitive prices. We have no assurances of continued supply, pricing or access to new products, and any vendor could at any time change the terms upon which it sells to us or discontinue selling to us. Member demands may lead to out-of-stock positions of our merchandise leading to loss of sales and profits.

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Item 1A—Risk Factors (Continued)

We purchase our merchandise from numerous domestic and foreign manufacturers and importers and have thousands of vendor relationships. Our inability to acquire suitable merchandise on acceptable terms or the loss of key vendors could negatively affect us. We may not be able to develop relationships with new vendors, and products from alternative sources, if any, may be of a lesser quality or more expensive than those from existing vendors. Because of our efforts to adhere to high quality standards for which available supply may be limited, particularly for certain food items, the large volume we demand may not be consistently available.

Our suppliers are subject to risks, including labor disputes, union organizing activities, financial liquidity, inclement weather, natural disasters, supply constraints, and general economic and political conditions that could limit their ability to timely provide us with acceptable merchandise. For these or other reasons, one or more of our suppliers might not adhere to our quality control, legal or regulatory standards. These deficiencies may delay or preclude delivery of merchandise to us and might not be identified before we sell such merchandise to our members. This failure could lead to litigation and recalls, which could damage our reputation and our brands, increase our costs, and otherwise adversely impact our business.

Natural disasters or other catastrophic events could negatively affect our business, financial condition and results of operations.

Natural disasters, such as hurricanes, typhoons or earthquakes, particularly in California or in Washington state, where our centralized operating systems and administrative personnel are located, could negatively affect our operations and financial performance. Such events could result in physical damage to one or more of our properties, the temporary closure of one or more warehouses or depots, the temporary lack of an adequate work force in a market, the temporary or long-term disruption in the supply of products from some local or overseas suppliers, the temporary disruption in the transport of goods to or from overseas, delays in the delivery of goods to our warehouses or depots within the countries in which we operate, and the temporary reduction in the availability of products in our warehouses. Public health issues, whether occurring in the U.S. or abroad, could disrupt our operations, disrupt the operations of suppliers or members, or have an adverse impact on consumer spending and confidence levels. These events could also reduce demand for our products or make it difficult or impossible to receive products from suppliers. We may be required to suspend operations in some or all of our locations, which could have a material adverse effect on our business, financial condition and results of operations.

Factors associated with climate change could adversely affect our business.

We use natural gas, diesel fuel, gasoline, and electricity in our distribution and warehouse operations. Increased U.S and foreign government and agency regulations to limit carbon dioxide and other greenhouse gas emissions may result in increased compliance costs and legislation or regulation affecting energy inputs that could materially affect our profitability. In addition, climate change could affect our ability to procure needed commodities at costs and in quantities we currently experience. We also sell a substantial amount of gasoline, the demand for which could be impacted by concerns about climate change and which also could face increased regulation. Climate change may be associated with extreme weather conditions, such as more intense hurricanes, thunderstorms, tornadoes and snow or ice storms, as well as rising sea levels. Extreme weather conditions increase our costs and damage resulting from extreme weather may not be fully insured.

Legal and Regulatory Risks

Our international operations subject us to risks associated with the legislative, judicial, accounting, regulatory, political and economic factors specific to the countries or regions in which we operate which could adversely affect our business, financial condition and results of operations.

During 2013, our international operations, including Canada, generated 28% of our consolidated net sales. We plan to continue expanding our international operations. As a result of these expansion activities in countries outside the U.S., we expect that our international operations could account for a larger portion of our net sales in future years. Future operating results internationally could be negatively affected by a variety of factors, many similar to those we face in the U.S., but many of which are beyond our control. These factors include political conditions, economic conditions, regulatory constraints, currency regulations and exchange rates, and other matters in any of the countries or regions in which we operate, now or in the future. Other factors that may impact international operations include foreign trade, monetary and fiscal policies and the laws and regulations of the U.S. and foreign governments, agencies and similar organizations, and risks associated with having major facilities located in countries which have been historically less stable than the U.S. Risks inherent in international operations also include, among others, the costs and difficulties of managing international operations, adverse tax consequences, and greater difficulty in enforcing intellectual property rights. Additionally, foreign currency exchange rates and fluctuations could have an adverse impact on our future costs or on future profits and cash flows from our international operations.

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Item 1A—Risk Factors (Continued)

Changes in accounting standards and subjective assumptions, estimates and judgments by management related to complex accounting matters could significantly affect our financial condition and results of operations.

Generally accepted accounting principles and related accounting pronouncements, implementation guidelines and interpretations with regard to a wide range of matters that are relevant to our business, including, but not limited to, revenue recognition, impairment of long-lived assets, merchandise inventories, vendor rebates and other vendor consideration, self-insurance liabilities, income taxes, unclaimed property laws and litigation, and other contingent liabilities are highly complex and involve many subjective assumptions, estimates and judgments by our management. Changes in these rules or their interpretation or changes in underlying assumptions, estimates or judgments by our management could significantly change our reported or expected financial performance.

Provisions for losses related to self-insured risks are generally based upon independent actuarially determined estimates. The assumptions underlying the ultimate costs of existing claim losses can be highly unpredictable, which can affect the liability recorded for such claims. For example, variability in inflation rates of health care costs inherent in these claims can affect the amounts realized. Similarly, changes in legal trends and interpretations, as well as a change in the nature and method of how claims are settled can impact ultimate costs. Although our estimates of liabilities incurred do not anticipate significant changes in historical trends for these variables, any changes could have a considerable effect upon future claim costs and currently recorded liabilities and could materially impact our consolidated financial statements.

We could be subject to additional income tax liabilities.

We compute our income tax provision based on enacted tax rates in the countries in which we operate. As the tax rates vary among countries, a change in earnings attributable to the various jurisdictions in which we operate could result in an unfavorable change in our overall tax provision. Additionally, any change in the enacted tax rates, any adverse outcome in connection with any income tax audits in any jurisdiction, including transfer pricing disputes, or any change in the pronouncements relating to accounting for income taxes could have a material adverse effect on our financial condition and results of operations.

Significant changes in, or failure to comply with, federal, state, regional, local and international laws and regulations relating to the use, storage, discharge and disposal of hazardous materials, hazardous and non-hazardous wastes and other environmental matters could adversely impact our business, financial condition and results of operations.

We are subject to a wide variety of federal, state, regional, local and international laws and regulations relating to the use, storage, discharge and disposal of hazardous materials, hazardous and non-hazardous wastes and other environmental matters. Any failure to comply with these laws could result in significant costs to satisfy environmental compliance, remediation or compensatory requirements, or the imposition of severe penalties or restrictions on operations by governmental agencies or courts that could adversely affect our business, financial condition and results of operations.

We are involved in a number of legal proceedings and audits and, while we cannot predict the outcomes of such proceedings and other contingencies with certainty, some of these outcomes could adversely affect our business, financial condition and results of operations.

Our business requires compliance with a great variety of laws and regulations. Failure to achieve compliance could subject us to lawsuits and other proceedings, and lead to damage awards, fines and penalties. We are, or may become involved, in a number of legal proceedings and audits including grand jury investigations, government and agency investigations, and consumer, employment, tort and other litigation (see discussion of Legal Proceedings in Note 11 to the consolidated financial statements included in Item 8 of this Report). We cannot predict with certainty the outcomes of these legal proceedings and other contingencies, including environmental remediation and other proceedings commenced by governmental authorities. The outcome of some of these legal proceedings, audits, unclaimed property laws, and other contingencies could require us to take, or refrain from taking, actions which could negatively affect our operations or could require us to pay substantial amounts of money adversely affecting our financial condition and results of operations. Additionally, defending against these lawsuits and proceedings may involve significant expense and diversion of management's attention and resources.

Item 1B—Unresolved Staff Comments

None.

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Item 2—Properties
Warehouse Properties
At September 1, 2013, we operated 634 membership warehouses:
NUMBER OF WAREHOUSES

	Own Land and Building	Lease Land and/or Building[1]	Total
United States and Puerto Rico	362	89	451
Canada	75	10	85
Mexico	32	1	33
United Kingdom	20	5	25
Japan	4	14	18
Taiwan	—	10	10
Korea	3	6	9
Australia	2	1	3
Total	498	136	634

(1) 95 of the 136 leases are land-leases only, where Costco owns the building.

The following schedule shows warehouse openings for the past five fiscal years and expected warehouse openings through December 31, 2013:

Openings by Fiscal Year[1]	United States	Canada	Other International[2]	Total	Total Warehouses in Operation
2009 and prior	406	77	44	527	527
2010	10	2	1	13	540
2011	13	3	36	52	592
2012	10	—	6	16	608
2013	12	3	11	26	634
2014 (expected through 12/31/2013)	10	2	3	15	649
Total	461	87	101	649	

(1) Net of closings.
(2) 2011 includes 32 Mexico warehouses in operation at the beginning of the year, when we began consolidating Mexico. These 32 warehouses were opened in 2009 and prior.

At the end of 2013, our warehouses contained approximately 90.8 million square feet of operating floor space: 65.5 million in the U.S.; 11.7 million in Canada; and 13.6 million in other international locations. Additionally, we operate regional cross-docking facilities (depots) for the consolidation and distribution of most merchandise shipments to the warehouses, and various processing, packaging, and other facilities to support ancillary and other businesses. We operate 22 depots consisting of approximately 9.0 million square feet. Our executive offices are located in Issaquah, Washington and we operate 16 regional offices in the U.S., Canada and other international locations.

Item 3—Legal Proceedings
See discussion of Legal Proceedings in Note 11 to the consolidated financial statements included in Item 8 of this Report.

Item 4—Mine Safety Disclosures
Not applicable.

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PART II

Item 5—Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Market Information and Dividend Policy

Our common stock is traded on the NASDAQ Global Select Market under the symbol “COST.” On October 9, 2013, we had 8,198 stockholders of record.

The following table shows the quarterly high and low closing sale prices as reported by NASDAQ for each quarter during the last two fiscal years and the quarterly cash dividend declared per share of our common stock.

	Price Range		Cash Dividends Declared	
	High	Low		
2013:				
Fourth Quarter	$120.07	$107.56	$0.310	
Third Quarter	109.99	99.45	0.310	
Second Quarter	105.95	96.26	7.275	(1)
First Quarter	102.75	94.47	0.275	
2012:				
Fourth Quarter	98.59	82.62	0.550	(2)
Third Quarter	91.84	83.24	—	(3)
Second Quarter	88.06	79.01	0.240	
First Quarter	85.30	77.79	0.240	

(1) The amount shown includes a special cash dividend of $7.00 per share.

(2) The amount shown includes the dividend declared on May 9, 2012, in addition to the fourth quarter dividend declared on July 23, 2012.

(3) On May 9, 2012, subsequent to the end of the third quarter of fiscal 2012, the Board of Directors declared a quarterly cash dividend of $0.275 per share.

Payment of future dividends is subject to declaration by the Board of Directors. Factors considered in determining dividends are our profitability and expected capital needs. Subject to these qualifications, we presently expect to continue to pay dividends on a quarterly basis.

Issuer Purchases of Equity Securities

There was no stock repurchase activity in the fourth quarter of fiscal 2013.

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Item 6—Selected Financial Data

The following table sets forth certain information concerning our consolidated financial condition, operating results, and key operating metrics. This information should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations, included in Item 7 of this Report, and our consolidated financial statements and notes thereto, included in Item 8 of this Report.

SELECTED FINANCIAL DATA

(dollars in millions, except per share and warehouse number data)

As of and for the year ended	Sept. 1, 2013 (52 weeks)	Sept. 2, 2012 (53 weeks)	Aug. 28, 2011 (52 weeks)	Aug. 29, 2010 (52 weeks)	Aug. 30, 2009 (52 weeks)
RESULTS OF OPERATIONS					
Net sales	$102,870	$97,062	$87,048	$76,255	$69,889
Merchandise costs	91,948	86,823	77,739	67,995	62,335
Gross margin	10,922	10,239	9,309	8,260	7,554
Membership fees	2,286	2,075	1,867	1,691	1,533
Operating income	3,053	2,759	2,439	2,077	1,777
Net income attributable to Costco(1)	2,039	1,709	1,462	1,303	1,086
Net income per diluted common share attributable to Costco	4.63	3.89	3.30	2.92	2.47
Cash dividends declared per common share	$8.17	$1.03	$0.89	$0.77	$0.68
Increase (decrease) in comparable warehouse sales(2)					
United States	6 %	7 %	7 %	4 %	(2 %)
International	6 %	6 %	16 %	19 %	(8 %)
Total	6 %	7 %	10 %	7 %	(4 %)
Increase in international comparable warehouse sales in local currency	6 %	8 %	10 %	8 %	7 %
BALANCE SHEET DATA(3)					
Net property and equipment	$13,881	$12,961	$12,432	$11,314	$10,900
Total assets	30,283	27,140	26,761	23,815	21,979
Current portion of long-term debt	—	1	900	—	80
Long-term debt, excluding current portion	4,998	1,381	1,253	2,141	2,130
Costco stockholders' equity	$10,833	$12,361	$12,002	$10,829	$10,024
WAREHOUSE INFORMATION					
Warehouses in Operation(4)					
Beginning of year(4)	608	592	572	527	512
Opened(5)	26	17	24	14	19
Closed(5)	0	(1)	(4)	(1)	(4)
End of year	634	608	592	540	527

(1) Includes 50% of the results of Costco Mexico's operations in fiscal 2009, 2010, 2011, and in 2012 prior to the July acquisition of our former joint venture partner's 50% equity interest. The remainder of fiscal 2012 and all of fiscal 2013 includes 100% of Costco Mexico's results of operations.

(2) Includes net sales at warehouses open more than one year, including relocations, remodels, and expansions, as well as online sales. For fiscal 2013 and 2012, the prior year includes the comparable 52 and 53 weeks, respectively.

(3) Excludes the balance sheet data for Costco Mexico for fiscal 2010 and 2009.

(4)

Excludes in 2010 and 2009 warehouses operated in Mexico through a 50% owned joint venture. Mexico opened 32 of these warehouses in 2009 and prior. The 2011 beginning-of-year figure includes these warehouses consolidated at the beginning of the fiscal year.

(5) Includes warehouse relocations and the closure in July 2009 of two Costco Home locations.

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Item 7—Management’s Discussion and Analysis of Financial Condition and Results of Operations (amounts in millions, except per share, membership fee data, and warehouse number data)

OVERVIEW

We believe that the most important driver of increasing our profitability is sales growth, particularly comparable sales growth. We define comparable warehouse sales as sales from warehouses open for more than one year, including remodels, relocations and expansions, as well as online sales. Comparable sales growth is achieved through increasing the frequency with which our members shop and the amounts that they spend on each visit. Sales comparisons can also be particularly influenced by two factors that are beyond our control, including fluctuations in currency exchange rates (with respect to the consolidation of the results of our international operations) and changes in the cost of gasoline and associated competitive conditions (primarily impacting domestic operations). The higher our comparable sales exclusive of currency fluctuations, the more we can leverage certain of our selling, general and administrative expenses, reducing them as a percentage of sales and enhancing profitability. Generating comparable sales growth is foremost a question of making available to our members the right merchandise at the right prices, a skill that we believe we have repeatedly demonstrated over the long term. Another substantial factor in sales growth is the health of the economies in which we do business, especially the United States. Sales growth and gross margins are also impacted by our competition, which is vigorous and widespread, including a wide range of global, national and regional wholesalers and retailers, including supermarkets, supercenter stores, and department and specialty stores, gasoline stations, and internet-based retailers. While we cannot control or reliably predict general economic health or changes in competition, we believe that we have been successful historically in adapting our business to these changes, such as through adjustments to our pricing and to our merchandise mix, including increasing the penetration of our private label items. Our philosophy is not to focus in the short term on maximizing prices that our members can be charged, but to maintain what we believe is a perception among our members of our “pricing authority” – consistently providing the most competitive values. This may cause us, for example, to absorb increases in merchandise costs at certain times rather than immediately passing them along to our members, negatively impacting gross margin.

We also achieve sales growth by opening new warehouses and, to a much lesser extent, relocating existing warehouses to larger and better-located facilities. As our warehouse base grows, available and desirable potential sites become more difficult to secure, and square footage growth becomes a comparatively less substantial component of growth. However, the negative aspects of such growth, including lower initial operating profitability relative to existing warehouses and cannibalization of sales at existing warehouses when openings occur in existing markets, are lessened. Our rate of square footage growth is higher in foreign markets, due to the smaller base in those markets, and we expect that to continue.

Our financial performance also depends heavily on our ability to control costs. While we believe that we have achieved successes in this area historically, some significant costs are partially outside our control, most particularly health care and utility expenses. With respect to expenses relating to the compensation of our employees, our philosophy is not to seek to minimize the wages and benefits that they earn. Rather, we believe that achieving our longer-term objectives of reducing employee turnover and enhancing employee satisfaction requires maintaining compensation levels that are better than the industry average for much of our workforce. This may cause us, for example, to absorb costs that other employers might seek to pass through to their workforces. Because our business is operated on very low margins, modest changes in various items in the income statement, particularly gross margin and selling, general and administrative expenses, can have substantial impacts on net income.

Our operating model is generally the same across our U.S., Canada, and Other International operating segments (see Note 12 to the consolidated financial statements included in Item 8 of this Report). Certain countries in the Other International segment have relatively higher rates of square footage growth, lower wages and benefit costs as a percentage of country sales, and/or less direct membership warehouse competition. Additionally, we operate our lower-margin gasoline business only in the United States and Canada.

In discussions of our consolidated operating results, we refer to the impact of changes in foreign currencies relative to the U.S. dollar, which are references to the differences between the foreign-exchange rates we use to convert the financial results of our international operations from local currencies into U.S. dollars for financial reporting purposes. This impact of foreign-exchange rate changes is typically calculated as the difference between the current period's currency exchange rates and the comparable prior-year period's currency exchange rates.

Our fiscal year ends on the Sunday closest to August 31. Fiscal years 2013 and 2011 were 52-week fiscal years ending on September 1, 2013 and August 28, 2011, respectively, while fiscal year 2012 was a 53-week fiscal year ending on September 2, 2012. Certain percentages presented are calculated using actual results prior to rounding. Unless otherwise noted, references to net income relate to net income attributable to Costco.

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Item 7—Management’s Discussion and Analysis of Financial Condition and Results of Operations (amounts in millions, except per share and share data, membership fee data, and warehouse number data) (Continued)

Highlights for fiscal year 2013 included:

- We opened 26 new warehouses in 2013, 12 in the U.S., three in Canada, and 11 in our Other International segment, compared to 16 net new warehouses in 2012.
- Net sales increased 6% to $102,870, driven by a 6% increase in comparable sales and sales at warehouses opened in 2012 and 2013, partially offset by the impact of one additional week of sales in 2012. Net sales were negatively impacted by changes in certain foreign currencies relative to the U.S. dollar;
- Membership fees increased 10% to $2,286, primarily due to the impact of raising our annual membership fees and membership sign-ups at both existing and new warehouses. These increases were partially offset by the impact of one additional week of fees in 2012;
- Gross margin (net sales less merchandise costs) as a percentage of net sales increased seven basis points;
- Selling, general and administrative (SG&A) expenses as a percentage of net sales increased one basis point;
- Net income in 2013 increased 19% to $2,039, or $4.63 per diluted share compared to $1,709, or $3.89 per diluted share in 2012. These results were positively impacted by a $62 tax benefit, or $0.14 per diluted share, in connection with the special cash dividend paid to the Company's 401(k) Plan participants;
- In December 2012, we paid a special cash dividend of $7.00 per share (approximately $3,049). Additionally, in December 2012, we issued $3,500 in aggregate principal amount of Senior Notes; and
- The Board of Directors approved an increase in the quarterly cash dividend from $0.275 to $0.31 per share in April 2013.

RESULTS OF OPERATIONS

Net Sales

	2013		2012		2011	
Net Sales	$102,870		$97,062		$87,048	
Increases in net sales:						
U.S.	5	%	11	%	9	%
International	8	%	14	%	31	% [2]
Total Company	6	%	12	%	14	% [2]
Increases in comparable warehouse sales[1]:						
U.S.	6	%	7	%	7	%
International	6	%	6	%	16	%
Total Company	6	%	7	%	10	%
Increases in comparable warehouse sales excluding the impact of gasoline price inflation and foreign currencies[1]:						
U.S.	6	%	6	%	5	%
International	6	%	8	%	10	%
Total Company	6	%	6	%	6	%

(1) For 2013 and 2012, the prior year includes the comparable 52 weeks and 53 weeks, respectively.

(2) The percentage increase in net sales for 2011 was positively impacted by the initial consolidation of Mexico beginning in fiscal 2011. Excluding Mexico, the International and Total Company increases in net sales would have been 18% and 11%, respectively.

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Item 7—Management's Discussion and Analysis of Financial Condition and Results of Operations (amounts in millions, except per share and share data, membership fee data, and warehouse number data) (Continued)

2013 vs. 2012

Net Sales

Net sales increased $5,808 or 6% during 2013 compared to 2012. This increase was attributable to a 6% increase in comparable warehouse sales and sales at warehouses opened in 2012 and 2013, partially offset by the impact of one additional week of sales in 2012.

Changes in foreign currencies relative to the U.S. dollar negatively impacted net sales by approximately $208, or 21 basis points during 2013. The negative impact was primarily due to the Japanese yen of approximately $354, partially offset by a positive impact of the Mexican peso of approximately $127. Changes in gasoline prices were immaterial to the change in net sales.

Comparable Sales

Comparable sales increased 6% during 2013 and were positively impacted by increases in both shopping frequency and the average amount spent by our members. Changes in foreign currencies relative to the U.S. dollar and gasoline prices were immaterial to the change in comparable sales. The increase in comparable sales includes the negative impact of cannibalization (established warehouses losing sales to our newly opened locations).

2012 vs. 2011

Net Sales

Net sales increased $10,014 or 12% during 2012 compared to 2011. This increase was attributable to a 7% increase in comparable warehouse sales, sales at warehouses opened in 2011 and 2012, and the benefit of one additional week of sales in 2012.

Gasoline price inflation positively impacted net sales by approximately $801 or 92 basis points, which resulted from an 8% increase in the average sales price per gallon during 2012. Changes in foreign currencies relative to the U.S. dollar negatively impacted net sales by approximately $597, or 69 basis points during 2012, primarily due to the Canadian dollar, the Mexican peso and the Korean won of approximately $310, $255 and $57, respectively, partially offset by a positive impact of the Japanese yen of approximately $81.

Comparable Sales

Comparable sales increased 7% during 2012, and were positively impacted by increases in both shopping frequency and the average amount spent by our members. Gasoline price inflation positively impacted comparable sales results during 2012, while changes in foreign currencies relative to the U.S. dollar negatively impacted comparable sales. The increase in comparable sales includes the negative impact of cannibalization (established warehouses losing sales to our newly opened locations).

Membership Fees

	2013		2012		2011	
Membership fees	$2,286		$2,075		$1,867	
Membership fees increase	10	%	11	%	10	%
Membership fees as a percent of net sales	2.22	%	2.13	%	2.15	%

2013 vs. 2012

Membership fees increased 10% in 2013. The increase was primarily due to raising our annual membership fees and membership sign-ups at both existing and new warehouses. These increases were partially offset by the impact of one additional week of membership fees in 2012. Our member renewal rates are currently 90% in the U.S. and Canada, and 86% on a worldwide basis.

We increased our annual membership fee in the U.S. and Canada effective November 1, 2011, for new members, and January 1, 2012, for renewal members. We increased our annual membership fee by $5 for U.S. Goldstar (individual), Business, Business add-on and Canada Business members to $55. Also, our U.S. and Canada Executive Membership annual fees increased from $100 to $110. We account for membership fee revenue, net of estimated refunds, on a deferred basis, whereby revenue is recognized ratably over the one-year membership period. These fee increases had a positive impact on membership fee

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Item 7—Management’s Discussion and Analysis of Financial Condition and Results of Operations (amounts in millions, except per share and share data, membership fee data, and warehouse number data) (Continued)

revenues of approximately $119 and $37 in 2013 and 2012, respectively. The remaining impact of this fee increase in 2014 will be immaterial.

2012 vs. 2011

Membership fees increased 11% in 2012. The increase was due to new member sign-ups at warehouses open for more than one year, an extra week of membership fee revenue in fiscal 2012, the impact of raising our annual membership fees, increased penetration of our higher-fee Executive Membership program, and additional member sign-ups at new warehouses opened since the end of fiscal 2011.

Gross Margin

	2013	2012	2011
Net sales	$102,870	$97,062	$87,048
Less merchandise costs	91,948	86,823	77,739
Gross margin	$10,922	$10,239	$9,309
Gross margin as a percent of net sales	10.62 %	10.55 %	10.69 %

2013 vs. 2012

Gross margin as a percentage of net sales increased seven basis points compared to 2012. Gross margin in our core merchandise categories (food and sundries, hardlines, softlines and fresh foods) when expressed as a percentage of net sales decreased four basis points, primarily due to a decrease in fresh foods as a result of our continued investment in merchandise pricing. Warehouse ancillary and other businesses gross margin when expressed as a percentage of net sales increased by six basis points, predominately in our optical and hearing aid businesses. Additionally, gross margin was positively impacted by five basis points due to a $27 LIFO inventory benefit in 2013, compared to a charge of $21 in 2012, and two basis points due to a legal settlement. The LIFO benefit resulted from lower costs for our merchandise inventories, primarily hardlines. Executive Membership 2% reward program negatively impacted gross margin by two basis points, due to increased spending by Executive Members.

Gross margin for core merchandise categories when expressed as a percentage of core merchandise sales (rather than total net sales) decreased two basis points, primarily due to a decrease in fresh foods.

Gross margin on a geographic segment basis, when expressed as a percentage of the segment’s own sales (gross margin percentage), increased in our U.S. operation primarily due to improvements in warehouse ancillary and other businesses. The LIFO benefit and legal settlement also benefited our U.S. operations. These improvements were slightly offset by a decrease in fresh foods. The gross margin percentage in our Canadian operations was flat, resulting from a decrease in fresh foods, offset by increases in warehouse ancillary and other businesses. The gross margin percentage in our Other International segment decreased, primarily in fresh foods.

2012 vs. 2011

Gross margin as a percent of net sales decreased 14 basis points compared to 2011. Gross margin for core merchandise categories decreased 21 basis points, primarily due to decreases in hardlines and food and sundries resulting from our investment in merchandise pricing. Excluding the effect of gasoline price inflation on net sales, gross margin for core merchandise categories decreased 13 basis points. The gross margin comparison was positively impacted by eight basis points due to a $21 LIFO inventory charge in 2012 compared to an $87 LIFO charge recorded in 2011. The LIFO charge resulted from higher costs for our merchandise inventories, primarily food and sundries and gasoline. Increased penetration of the Executive Membership 2% reward program negatively impacted gross margin by two basis points due to increased spending by Executive Members.

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Item 7—Management’s Discussion and Analysis of Financial Condition and Results of Operations (amounts in millions, except per share and share data, membership fee data, and warehouse number data) (Continued)

Selling, General and Administrative Expenses

	2013	2012	2011
SG&A expenses	$10,104	$9,518	$8,691
SG&A expenses as a percent of net sales	9.82 %	9.81 %	9.98 %

2013 vs. 2012

SG&A expenses as a percent of net sales increased one basis point compared to 2012. This increase was driven by higher stock compensation expense of three basis points, partially offset by contributions made to an initiative reforming alcohol beverage laws in Washington State in the first quarter of 2012, with no comparable charge in 2013, which resulted in a positive impact of two basis points. Central operating costs as a percent of net sales were flat, primarily due to the benefit of lower non-equity incentive compensation costs as a result of not meeting certain internal performance targets. This was offset by higher central operating costs, predominately related to the continued investment in the modernization of our information systems in our U.S. operations. Warehouse operating costs as a percentage of net sales was flat, primarily due to leveraging payroll costs in our U.S. and Canadian operations as a result of increased net sales which was offset by increases in other operating costs, primarily employee benefits and workers' compensation.

2012 vs. 2011

SG&A expenses as a percent of net sales improved 17 basis points compared to 2011. Excluding the effect of gasoline price inflation, SG&A expenses improved nine basis points, primarily due to an eleven basis point improvement in our warehouse operating costs, largely payroll. This improvement was partially offset by contributions to an initiative reforming alcohol beverage laws in Washington State and higher stock compensation expense, which had negative impacts of two basis points each. Higher costs related to the modernization of our information systems and related activities, which includes the re-platforming of our e-commerce sites, also adversely impacted our SG&A percentage.

Preopening Expenses

	2013	2012	2011
Preopening expenses	$51	$37	$46
Warehouse openings, including relocations			
United States	12	10	15
Canada	3	1	3
Other International	11	6	6
Total warehouse openings, including relocations	26	17	24

Preopening expenses include costs for startup operations related to new warehouses and the expansion of ancillary operations at existing warehouses. Preopening expenses vary due to the number of warehouse openings, the timing of the opening relative to our year-end, whether the warehouse is owned or leased, and whether the opening is in an existing, new, or international market.

Interest Expense

	2013	2012	2011
Interest expense	$99	$95	$116

Interest expense in 2013 primarily relates to our $1,100 of 5.5% Senior Notes issued in fiscal 2007 and our $3,500 of Senior notes issued in December 2012 (described in further detail under the heading “Financing Activities” and in Note 4 to the consolidated financial statements included in Item 8 of this Report). The outstanding principal balance and associated interest on the $900 of 5.3% Senior Notes was paid in March 2012, resulting in a decrease in interest expense in 2012.

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Item 7—Management’s Discussion and Analysis of Financial Condition and Results of Operations (amounts in millions, except per share and share data, membership fee data, and warehouse number data) (Continued)

Interest Income and Other, Net

	2013	2012	2011
Interest income	$44	$49	$41
Foreign-currency transaction gains, net	39	40	9
Other, net	14	14	10
Interest income and other, net	$97	$103	$60

2013 vs. 2012
The decrease in interest income in 2013 compared to 2012 was primarily attributable to lower interest rates earned on our U.S. cash balances. There was a decrease in the positive impact of net foreign-currency transaction gains resulting from the revaluation or settlement of monetary assets and monetary liabilities during the year. This was partially offset by a positive impact of mark-to-market adjustments related to foreign exchange contracts entered into by our foreign subsidiaries, as the U.S. dollar was slightly stronger in certain international locations compared to 2012. See Derivatives and Foreign Currency sections in Note 1 to the consolidated financial statements included in Item 8 of this Report.
2012 vs. 2011
The increase in interest income in 2012 compared to 2011 was attributable to higher cash balances and interest rates in our foreign subsidiaries. The changes in foreign-currency transaction gains and losses, net in 2012 compared to 2011 were related to the revaluation or settlement of monetary assets and monetary liabilities, primarily our Canadian subsidiary’s U.S. dollar-denominated payables.
Provision for Income Taxes

	2013		2012		2011	
Provision for income taxes	$990		$1,000		$841	
Effective tax rate	32.4	%	36.1	%	35.3	%

2013 vs. 2012
Our provision for income taxes for 2013 was favorably impacted by nonrecurring net tax benefits of $77, primarily due to a $62 tax benefit recorded in the second quarter in connection with the special cash dividend paid to employees through our 401(k) Retirement Plan. Dividends paid on these shares are deductible for U.S. income tax purposes.
2012 vs. 2011
Our provision for income taxes for 2012 was adversely impacted by nonrecurring net tax expense of $25 relating primarily to the following items: the adverse impact of an audit of Costco Mexico by the Mexican tax authority; the tax effects of a cash dividend declared by Costco Mexico; and the tax effects of nondeductible expenses for our contribution to an initiative reforming alcohol beverage laws in Washington State.

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Item 7—Management's Discussion and Analysis of Financial Condition and Results of Operations (amounts in millions, except per share and share data, membership fee data, and warehouse number data) (Continued)

LIQUIDITY AND CAPITAL RESOURCES

Cash Flows

The following table summarizes our significant sources and uses of cash and cash equivalents:

	2013 (52 Weeks)	2012 (53 Weeks)	2011 (52 Weeks)
Net cash provided by operating activities	$3,437	$3,057	$3,198
Net cash used in investing activities	(2,251)	(1,236)	(1,180)
Net cash provided by (used in) financing activities	44	(2,281)	(1,277)

Our primary sources of liquidity are cash flows generated from warehouse operations, cash and cash equivalents and short-term investment balances. Cash and cash equivalents and short-term investments were $6,124 and $4,854 at the end of 2013 and 2012, respectively. Of these balances, approximately $1,254 and $1,161 at the end of 2013 and 2012, respectively, represented debit and credit card receivables, primarily related to sales in the last week of our fiscal year.

Net cash provided by operating activities totaled $3,437 in 2013 compared to $3,057 in 2012. Our cash flow provided by operations is primarily derived from net sales and membership fees. Our cash flow used in operations generally consist of payments to our merchandise vendors, warehouse operating costs including payroll and employee benefits, utilities and credit card processing fees. Cash used in operations also includes payments for income taxes.

Net cash used in investing activities totaled $2,251 in 2013 compared to $1,236 in 2012. Our cash flow used in investing activities is primarily related to funding our warehouse expansion and remodeling activities. We opened a total of 26 and 17 new warehouses in 2013 and 2012, respectively, and plan to open 30 to 36 new warehouses in 2014. Net cash used for purchases of short-term investments in 2013 included the investment of the excess proceeds from the issuance of long-term debt (described below).

Net cash provided by financing activities totaled $44 in 2013, compared to $2,281 used in financing activities in 2012. Our cash provided by financing activities primarily resulted from the proceeds of the issuance of long-term debt, largely the issuance of $3,500 in aggregate principal amount of Senior Notes. The majority of these proceeds were used to fund the special cash dividend. Additionally, cash used for repurchases of our common stock was minimal in 2013. In 2012, cash used also included the repayment of long-term debt and purchase of the non-controlling interest in Costco Mexico.

The effect of changes in foreign-exchange rates decreased cash and cash equivalents by $114 in 2013, compared to $21 in 2012. This was predominately due to the weakening of the Canadian dollar and Japanese yen.

Management believes that our cash position and operating cash flows will be sufficient to meet our capital requirements for the foreseeable future. We have not provided for U.S. deferred taxes on cumulative undistributed earnings of certain non-U.S. consolidated subsidiaries as we deem such earnings to be indefinitely reinvested. We believe that our U.S. current and projected asset position is sufficient to meet our U.S. liquidity requirements and we have no current plans to repatriate the cash, cash equivalents, and short-term investments held by these subsidiaries for use in the U.S. At September 1, 2013, cash and cash equivalents and short-term investments totaling $2,320 were held by these non-U.S. consolidated subsidiaries.

Dividends

In April 2013, our Board of Directors increased our quarterly cash dividend from $0.275 to $0.31 per share. Additionally, in November 2012, the Board of Directors declared a special cash dividend of $7.00 per share. This dividend was paid in December 2012 in the amount of $3,049. Our cash dividends paid in 2013 totaled $8.17 per share as compared to $1.03 per share in 2012.

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Item 7—Management's Discussion and Analysis of Financial Condition and Results of Operations (amounts in millions, except per share and share data, membership fee data, and warehouse number data) (Continued)

Contractual Obligations

As of September 1, 2013, our commitments to make future payments under contractual obligations were as follows:

	Payments Due by Fiscal Year				
Contractual obligations	2014	2015 to 2016	2017 to 2018	2019 and thereafter	Total
Purchase obligations (merchandise)(1)	$5,573	$1	$—	$—	$5,574
Long-term debt(2)	106	1,510	2,426	1,440	5,482
Operating leases (3)	189	342	313	1,753	2,597
Purchase obligations (property, equipment, services and other)(4)	339	76	—	—	415
Construction commitments	465	—	—	—	465
Capital lease obligations(2)	17	33	32	338	420
Other(5)	14	21	24	50	109
Total	$6,703	$1,983	$2,795	$3,581	$15,062

(1) Includes only open merchandise purchase orders.

(2) Includes contractual interest payments.

(3) Operating lease obligations exclude amounts for common area maintenance, taxes, and insurance and have been reduced by $150 to reflect sub-lease income.

(4) The amounts exclude certain services negotiated at the individual warehouse or regional level that are not significant and generally contain clauses allowing for cancellation without significant penalty.

(5) Consists of $50 in asset retirement obligations, $55 in deferred compensation obligations, and $4 of current unrecognized tax benefits relating to uncertain tax positions. The total amount excludes $215 of deferred compensation, $53 of non-current unrecognized tax benefits, and $24 of other obligations due to uncertainty regarding the timing of future cash payments.

Expansion Plans

Our primary requirement for capital is the financing of land, buildings, and equipment for new and remodeled warehouses. To a lesser extent, capital is required for initial warehouse operations and working capital. While there can be no assurance that current expectations will be realized and plans are subject to change upon further review, it is our current intention to spend approximately $2,300 to $2,500 during fiscal 2014 for real estate, construction, remodeling, equipment for warehouses and related operations, and the modernization of our information systems and related activities. These expenditures are expected to be financed with a combination of cash provided from operations and existing cash and cash equivalents and short-term investments.

We plan to open 30 to 36 new warehouses in 2014. In 2013, we opened 26 new warehouses and spent a total of $2,083 on capital expenditures.

Bank Credit Facilities and Commercial Paper Programs

As of September 1, 2013, we had total borrowing capacity within our bank credit facilities of $700, of which $381 was maintained by our international operations. Of the $381 maintained by our international operations, $183 is guaranteed by the Company. We maintain bank credit facilities for working capital and general corporate purposes. There were $36 in outstanding short-term borrowings under the bank credit facilities at the end of 2013 and none outstanding as of the end of 2012. The Company has letter of credit facilities, for commercial and stand-by letters of credit, totaling $154. The outstanding commitments under these facilities at the end of 2013 totaled $96, including $91 million in stand-by letters of credit with expiration dates within one year. All of the bank credit facilities have various expiration dates, all within one year, and generally, we intend to renew these facilities prior to their expiration. The amount of borrowings available at any time under our bank credit facilities is reduced by the amount of standby and commercial letters of credit outstanding at that time.

Financing Activities

In December 2012, we issued $3,500 in aggregate principal amount of Senior Notes as follows: $1,200 of 0.65% Senior Notes due December 7, 2015; $1,100 of 1.125% Senior Notes due December 15, 2017; and $1,200 of 1.7% Senior Notes due December 15, 2019. The proceeds from the issuance of these Senior Notes were used primarily to pay the special cash dividend

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on our common stock. The balance of approximately $450 was used to invest in short-term investments. See Note 4 to the consolidated financial statements included in Item 8 of this Report for additional information.

In July 2013, our Japanese subsidiary entered into an approximately $102 three-year term loan (with a possible two year extension), bearing interest at 0.67%. Interest is payable semi-annually, and principal is due on June 30, 2016.

In May 2013, our Japanese subsidiary issued approximately $102 of 1.05% promissory notes through a private placement. Interest is payable semiannually, and principal is due in May 2023.

Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements that have had, or are reasonably likely to have, a material current or future effect on our financial condition or consolidated financial statements.

Stock Repurchase Programs

In April 2011, our Board of Directors authorized a stock repurchase program in the amount of $4,000, expiring in April 2015, bringing total authorizations by our Board of Directors since inception of the program in 2001 to $10,800. The authorization in April 2011 revoked previously authorized but unused amounts totaling $792.

During 2013 and 2012, we repurchased 357,000 and 7,272,000 shares of common stock, at an average price of $96.41 and $84.75, totaling approximately $34 and $617, respectively. The remaining amount available to be purchased under our approved plan was $3,055 at the end of 2013. 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.

Critical Accounting Estimates

The preparation of our consolidated financial statements in accordance with U.S. generally accepted accounting principles requires that we make estimates and judgments. We continue to review our accounting policies and evaluate our estimates, including those related to revenue recognition, investments, merchandise inventory valuation, impairment of long-lived assets, insurance/self-insurance liabilities, and income taxes. We base our estimates on historical experience and on assumptions that we believe to be reasonable. For further information on key accounting policies, see discussion in Note 1 to the consolidated financial statements included in Item 8 of this Report.

Revenue Recognition

We generally recognize sales, which include shipping fees where applicable, net of estimated returns, at the time the member takes possession of merchandise or receives services. When we collect payment from customers prior to the transfer of ownership of merchandise or the performance of services, the amount received is generally recorded as deferred revenue on the consolidated balance sheets until the sale or service is completed. We provide for estimated sales returns based on historical trends in merchandise returns, net of the estimated net realizable value of merchandise inventories to be returned and any estimated disposition costs. Amounts collected from members that under common trade practices are referred to as sales taxes are recorded on a net basis.

We evaluate whether it is appropriate to record the gross amount of merchandise sales and related costs or the net amount earned as commissions. Generally, when we are the primary obligor, subject to inventory risk, have latitude in establishing prices and selecting suppliers, influence product or service specifications, or have several but not all of these indicators, revenue and related shipping fees are recorded on a gross basis. If we are not the primary obligor and do not possess other indicators of gross reporting as noted above, we record the net amounts as commissions earned, which is reflected in net sales.

We account for membership fee revenue, net of estimated refunds, on a deferred basis, whereby revenue is recognized ratably over the one-year membership period. Our Executive members qualify for a 2% reward (up to a maximum of approximately $750 per year), which can be redeemed only at Costco warehouses on qualified purchases made at Costco warehouses. We account for this reward as a reduction in sales. The sales reduction and corresponding liability are computed after giving effect to the estimated impact of non-redemptions based on historical data.

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Item 7—Management's Discussion and Analysis of Financial Condition and Results of Operations (amounts in millions, except per share and share data, membership fee data, and warehouse number data) (Continued)

Investments

Investments are reviewed quarterly for indicators of other-than-temporary impairment. This determination requires significant judgment. We employ a methodology that considers available quantitative and qualitative evidence. If the cost of an investment exceeds its fair value, we evaluate, among other factors, general market conditions, the duration and extent to which the fair value is less than cost, and our intent and ability to hold the investment. We also consider specific adverse conditions related to the financial health of and business outlook for the issuer, including industry and sector performance, operational and financing cash flow factors, and rating agency actions. Once a decline in fair value is determined to be other-than-temporary, an impairment charge is recorded and a new cost basis in the investment is established. If market, industry, or issuer conditions deteriorate, we may incur future impairments.

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. We believe the LIFO method more fairly presents the results of operations by more closely matching current costs with current revenues. We record an adjustment each quarter, if necessary, for the estimated effect of inflation or deflation, and these estimates are adjusted to actual results determined at year-end. We provide for estimated inventory losses (shrink) between physical inventory counts as a percentage of net sales. The provision is adjusted periodically to reflect results of the actual physical inventory counts, which generally occur in the second and fourth quarters of the year.

Inventory cost, where appropriate, is reduced by estimates of vendor rebates when earned or as we progress toward earning those rebates, provided they are probable and reasonably estimable. Other consideration received from vendors is generally recorded as a reduction of merchandise costs upon completion of contractual milestones, terms of agreement, or other systematic and rational approaches.

Impairment of Long-Lived Assets

We periodically evaluate our long-lived assets for indicators of impairment, such as a decision to relocate or close a warehouse facility. Our judgments are based on existing market and operational conditions. Future events could cause us to conclude that impairment factors exist, requiring a downward adjustment of these assets to their then-current fair market value.

Insurance/Self-Insurance Liabilities

We use a combination of insurance and self-insurance mechanisms, including a wholly-owned captive insurance subsidiary and participation in a reinsurance pool, to provide for potential liabilities for workers' compensation, general liability, property damage, directors' and officers' liability, vehicle liability, and employee health care benefits. Liabilities associated with the risks that we retain are not discounted and are estimated, in part, by considering historical claims experience, demographic factors, severity factors and other actuarial assumptions. The estimated accruals for these liabilities could be significantly affected if future occurrences and claims differ from these assumptions and historical trends.

Income Taxes

The determination of our provision for income taxes requires significant judgment, the use of estimates, and the interpretation and application of complex tax laws. Significant judgment is required in assessing the timing and amounts of deductible and taxable items and the probability of sustaining uncertain tax positions. The benefits associated with uncertain tax positions are recorded in our consolidated financial statements only after determining a more-likely-than-not probability that the positions will withstand challenge from tax authorities. When facts and circumstances change, we reassess these probabilities and record any changes in the consolidated financial statements as appropriate.

Recent Accounting Pronouncements

See Note 1 to the consolidated financial statements included in Item 8 of this Report for a detailed description of recent accounting pronouncements. We do not expect these accounting pronouncements to have a material impact on our results of operations, financial condition or liquidity in future periods.

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Item 7A—Quantitative and Qualitative Disclosures About Market Risk (amounts in millions)

Our exposure to financial market risk results from fluctuations in interest rates and foreign currency exchange rates. We do not engage in speculative or leveraged transactions or hold or issue financial instruments for trading purposes.

Interest Rate Risk

Our exposure to market risk for changes in interest rates relates primarily to our investment holdings that are diversified among various instruments considered to be cash equivalents as defined in Note 1 to the consolidated financial statements included in Item 8 of this Report, as well as short-term investments in government and agency securities, and corporate notes and bonds with effective maturities of generally three months to five years at the date of purchase. The primary objective of our investment activities is to preserve principal and secondarily to generate yields. The majority of our short-term investments are in fixed interest rate securities. These securities are subject to changes in fair value due to interest rate fluctuations.

Our Board of Directors have approved a policy that limits investments in the U.S. to direct U.S. government and government agency obligations, repurchase agreements collateralized by U.S. government and government agency obligations, and U.S. government and government agency money market funds. Our wholly-owned captive insurance subsidiary invests in U.S. government and government agency obligations, corporate notes and bonds, and asset and mortgage-backed securities with a minimum overall portfolio average credit rating of AA+.

Our Canadian and other international subsidiaries' investments are primarily in money market funds, bankers' acceptances, bank certificates of deposit and term deposits, generally denominated in their local currencies.

We performed a sensitivity analysis to determine the impact that a 100 basis-point change in interest rates would have on the value of our investment portfolio. At the end of 2013 and 2012, the incremental change in the fair market value was immaterial. For those investments that are classified as available-for-sale, the unrealized gains or losses related to fluctuations in market volatility and interest rates are reflected within stockholders' equity in accumulated other comprehensive income.

The nature and amount of our long-term debt may vary as a result of future business requirements, market conditions and other factors. As of the end of 2013, the majority of our long-term debt is fixed rate Senior Notes, carried at $4,595. Fluctuations in interest rates may affect the fair value of the fixed-rate debt and may affect the interest expense related to the variable rate debt. See Note 4 to the consolidated financial statements included in Item 8 of this Report for more information on our long-term debt.

Foreign Currency-Exchange Risk

Our foreign subsidiaries conduct certain transactions in their non-functional currencies, which exposes us to fluctuations in exchange rates. We manage these fluctuations, in part, through the use of forward foreign-exchange contracts, 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 our international subsidiaries whose functional currency is other than the U.S. dollar. Currently, these contracts do not qualify for derivative hedge accounting. We seek to mitigate risk with the use of these contracts and do not intend to engage in speculative transactions. These contracts do not contain any credit-risk-related contingent features.

We seek to manage counterparty risk associated with these contracts by limiting transactions to counterparties with which we have established banking relationships. There can be no assurance, however, that this practice effectively mitigates counterparty risk. These contracts are limited to less than one year in duration. See Note 1 and Note 3 to the consolidated financial statements included in Item 8 of this Report for additional information on the fair value of open, unsettled forward foreign-exchange contracts at the end of 2013 and 2012. A hypothetical 10% strengthening of the functional currency compared to the non-functional currency exchange rates at September 1, 2013 and September 2, 2012, would have decreased the fair value of the contracts by $45 and $28, respectively.

Commodity Price Risk

We are exposed to fluctuations in prices for energy that we consume, particularly electricity and natural gas, which we seek to partially mitigate through fixed-price contracts for certain of our warehouses and other facilities, primarily in the U.S. and Canada. We also enter into variable-priced contracts for some purchases of electricity and natural gas, in addition to fuel for our 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.

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Item 8—Financial Statements and Supplementary Data

The following documents are filed as part of Part II, Item 8 of this Report on the pages listed below:

Management’s Report on the Consolidated Financial Statements

Costco’s management is responsible for the preparation, integrity and objectivity of the accompanying consolidated financial statements and the related financial information. The consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles and necessarily include certain amounts that are based on estimates and informed judgments. The Company’s management is also responsible for the preparation of the related financial information included in this Annual Report on Form 10-K and its accuracy and consistency with the consolidated financial statements.

The consolidated financial statements have been audited by KPMG LLP, an independent registered public accounting firm, who conducted their audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). The independent registered public accounting firm’s responsibility is to express an opinion as to the fairness with which such consolidated financial statements present our financial position, results of operations and cash flows in accordance with U.S. generally accepted accounting principles.

Item 9—Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A—Controls and Procedures

Disclosure Controls and Procedures

As of the end of the period covered by this Annual Report on Form 10-K, we performed an evaluation under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer, of our disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e) under the Securities and Exchange Act of 1934 (the Exchange Act)). Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this Annual Report, our disclosure controls and procedures are effective.

There has been no change in our internal control over financial reporting (as defined in Rules 13a-15(f) or 15d-15(f) of the Exchange Act) during our most recently completed fiscal year that has materially affected or is reasonably likely to materially affect our internal control over financial reporting.

Management’s Annual Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) under the Exchange Act. Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles and includes those policies and procedures that: (1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect our transactions and the dispositions of our assets; (2) provide reasonable assurance that our transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles and that our receipts and expenditures are being made

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Item 9A—Controls and Procedures (Continued)

only in accordance with appropriate authorizations; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on our financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Under the supervision and with the participation of our management, we assessed the effectiveness of our internal control over financial reporting as of September 1, 2013, using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control—Integrated Framework (1992). Based on its assessment, management has concluded that our internal control over financial reporting was effective as of September 1, 2013. The attestation of KPMG LLP, our independent registered public accounting firm, on the effectiveness of our internal control over financial reporting is included with the consolidated financial statements in Item 8 of this Report.

/s/ W. CRAIG JELINEK
W. Craig Jelinek
President and Chief Executive Officer

/s/ RICHARD A. GALANTI
Richard A. Galanti
Executive Vice President and Chief Financial Officer

Item 9B—Other Information (amounts in whole dollars)

Disclosure pursuant to Section 219 of the Iran Threat Reduction and Syria Human Rights Act of 2012 and Section 13(r) of the Securities Exchange Act of 1934, as amended.

As reported in the Company’s prior quarterly report filed on Form 10-Q for the quarter ended May 12, 2013, in the fourth quarter of 2013, the Company canceled a business membership at our Japan subsidiary in the name of the Embassy of the Islamic Republic of Iran. The cancellation of this membership was initiated in June 2013, although the members inadvertently were able to make purchases until August 2013. $1,032 in revenue and an estimated $13 in net profits were earned in the fourth quarter of 2013.

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PART III

Item 10—Directors, Executive Officers and Corporate Governance

Information relating to the availability of our code of ethics for senior financial officers and a list of our executive officers appear in Item 1 of this Report. The information required by this Item concerning our directors and nominees for director is incorporated herein by reference to the sections entitled "Proposal 1: Election of Directors," "Directors," "Committees of the Board" and "Section 16(a) Beneficial Ownership Reporting Compliance" in Costco's Proxy Statement for its 2014 annual meeting of stockholders, which will be filed with the SEC within 120 days of the end of our fiscal year ("Proxy Statement").

Item 11—Executive Compensation

The information required by this Item is incorporated herein by reference to the sections entitled "Compensation of Directors," "Executive Compensation," and "Compensation Discussion and Analysis" in Costco's Proxy Statement.

Item 12—Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required by this Item is incorporated herein by reference to the section entitled "Principle Shareholders" and "Equity Compensation Plan Information" in Costco's Proxy Statement.

Item 13—Certain Relationships and Related Transactions, and Director Independence

The information required by this Item is incorporated herein by reference to the sections entitled "Proposal 1: Election of Directors," "Directors," "Committees of the Board," "Shareholder Communications to the Board," "Meeting Attendance," "Report of the Compensation Committee of the Board of Directors," "Certain Relationships and Transactions" and "Report of the Audit Committee" in Costco's Proxy Statement.

Item 14—Principal Accounting Fees and Services

The information required by this Item is incorporated herein by reference to the sections entitled "Independent Public Accountants" in Costco's Proxy Statement.

PART IV

Item 15—Exhibits, Financial Statement Schedules

(a) Documents filed as part of this report are as follows:

1. Financial Statements:

See the listing of Financial Statements included as a part of this Form 10-K on Item 8 of Part II.

2. Financial Statement Schedules:

All schedules have been omitted because the required information is not present or is not present in amounts sufficient to require submission of the schedule, or because the information required is included in the consolidated financial statements, including the notes thereto.

3. Exhibits:

The required exhibits are included at the end of the Form 10-K Annual Report and are described in the Exhibit Index immediately preceding the first exhibit.

(b) Financial Statement Schedules—None.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

October 16, 2013

COSTCO WHOLESALE CORPORATION
(Registrant)

By /s/ RICHARD A. GALANTI
Richard A. Galanti
Executive Vice President
and Chief Financial Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

By	/s/ W. CRAIG JELINEK W. Craig Jelinek President, Chief Executive Officer and Director	October 16, 2013
By	/s/ JEFFREY H. BROTMAN Jeffrey H. Brotman Chairman of the Board	October 16, 2013
By	/s/ RICHARD A. GALANTI Richard A. Galanti Executive Vice President, Chief Financial Officer and Director (Principal Financial Officer)	October 16, 2013
By	/s/ DAVID S. PETTERSON David S. Petterson Senior Vice President and Controller (Principal Accounting Officer)	October 16, 2013
By	/s/ BENJAMIN S. C	