



## Financial Analysis Report

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Financial Statements: BJ's Wholesale Club Inc.

Financial Statements: Costco Wholesale Corp.

## I. Company Overview<sup>1</sup>

BJ's Wholesale Club Inc. (BJ's) operates warehouse clubs located in the eastern United States. BJ's aims to provide "its members with high-quality, brand name merchandise at prices that are significantly lower than the prices found at supermarkets, super-centers, department stores, drug stores, and specialty retail stores".<sup>2</sup> As of February 3, 2007, BJ's operated 172 clubs across 16 states spanning from Maine to Florida. Of the 172 clubs, 96 of them operated gas stations. BJ's generates revenues through the sale of various foods, general merchandise, and gasoline. Club membership fees also contribute to its revenues (the company had about 8.7 million paid members as of February 3, 2007<sup>3</sup>). The table below compares percent of total revenue from net sales versus percent of total revenue from membership fees and other.

BJ's, Fiscal Year Ended Feb. 03, 2007 <sup>4</sup>	
% Total Revenue from Net Sales	97.9%
% Total Revenue from Membership fees and other	2.1%

Types of foods (and related products) that BJ's offers includes frozen foods, fresh meat and dairy, beverages, dry grocery items, fresh produce and flowers, canned goods, and household paper products. BJ's general merchandise includes consumer electronics, pre-recorded media, small appliances, tires, jewelry, health and beauty aids, household needs, computer software, books, greeting cards, apparel, furniture, toys, and seasonal items. BJ's also offers specialty services, mostly through leasing space to external operators. Optical centers, food courts, photo developing, and Verizon Wireless services centers are some examples of the specialty services at BJ's.<sup>5</sup> BJ's limits its merchandise to top brands and private label goods. In order to keep operating costs as low as possible, the company also orders full truck loads of products directly from the manufacturer. Once inventory is received, it is placed directly on the sales floor.<sup>6</sup> Typical BJ's customers are individual households and small businesses.<sup>7</sup>

## II. Industry<sup>8,9</sup>

BJ's is classified as part of the Hypermarkets and Super Centers sub-industry, as defined by the Global Industry Classification Standard (GICS). Broader GICS classifications for BJ's are Food & Staples Retailing at the industry & industry group

<sup>1</sup> Yahoo Finance, BJ's, *Company Profile* <http://finance.yahoo.com/q/pr?s=BJ>

<sup>2</sup> BJ's Wholesale Club 2006 Annual Report, *Company Profile*

<sup>3</sup> S&P Net Advantage, BJ's, *Business Summary*

<sup>4</sup> BJ's Wholesale Club 2006 Annual Report, Revenue Values from *Item 6. Selected Financial Data*

<sup>5</sup> Reuters, BJ's, *Company Overview*

<http://stocks.us.reuters.com/stocks/fullDescription.asp?symbol=BJ&WTmodLOC=C5-Profile-1>

<sup>6</sup> S&P Net Advantage, BJ's, *Business Summary*

<sup>7</sup> BJ's charges \$45 per year for an Inner Circle membership and \$80 per year for a BJ's Rewards membership, which offers additional benefits on top of the Inner Circle membership such as a 2% payback on most in-Club purchases and on all online purchases. Individuals that live at the same address as a primary member can purchase a supplemental membership for \$20/year.

<sup>8</sup> Wikipedia, Warehouse Clubs [http://en.wikipedia.org/wiki/Warehouse\\_club](http://en.wikipedia.org/wiki/Warehouse_club)

<sup>9</sup> BJ's Wholesale Club 2006 Annual Report, *Company Profile*

levels and Consumer Staples at the sector level<sup>10</sup> (broadest GICS level). Specifically, as stated above, BJ's is in the business of operating warehouse clubs.

Warehouse clubs can generally be described as stores that sell a wide variety of products wholesale at low prices to its customers, who are charged membership fees to be able to shop at these clubs. Prices are kept low because the products are sold wholesale (typically in large quantities), from no-frills, self service facilities. Warehouse clubs seek to generate high sales volumes and inventory turnover in exchange for low margins (the difference in price that a product is purchased for by the club versus what it is sold for to the consumer).

### **III. Competitors<sup>11,12</sup>**

Costco and Sam's Club are two of BJ's main competitors. According to Yahoo Finance, they are the number one and two (respectively) US warehouse club chains.<sup>13</sup> As of October, 2007, Costco operated 520 warehouses worldwide, the majority being located in the U.S. and Canada.<sup>14</sup> Costco's product mix includes food & beverages, tobacco, cleaning & institutional supplies, appliances, electronics, health and beauty aids, office supplies, garden and patio, sporting goods, furniture, automotive supplies, apparel, jewelry, media, home furnishings, cameras, gas stations, pharmacy, food court, optical, one-hour photo, hearing aid, and travel.<sup>15</sup> Sam's Club is a division of the Wal-Mart stores. 12% of Wal-Mart's sales are attributed to Sam's Club, which operates about 575 stores. 48 of these stores are located in the US. There are also about 100 stores in Brazil, Canada, China, Mexico, and Puerto Rico. Sam's Club also offers a wide variety of products & services including bulk office supplies and food, electronic goods, jewelry, clothes, insurance and travel services, and Member's Mark store-brand products.

### **IV. Risks<sup>16</sup>**

There are several risk factors that BJ's will encounter in the future that will affect its financial condition and business operation. Some risk factors are unique to BJ's while others are standard risk factors that are applicable to the entire industry. The standard risk factors for BJ's include the condition of the economy, change in laws, condition of the industry, terrorism, health issues, and consumer spending.

One risk factor that is exclusive to BJ's is competition. BJ's competes with national, regional, and local retailers for customers. Competitors like Wal-Mart and Costco have more financial and marketing resources than BJ's. The differences in price, location, and product offerings differentiate BJ's from other retailers in the industry. BJ's cannot guarantee that it will be able to compete successfully with other retailers. Thus, the inability to compete would lead to lower sales and lower profitability.

The second risk that BJ's encounters is not having the financial ability to open new clubs and gas stations. Opening new clubs is crucial to growth and increasing

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<sup>10</sup> S&P Compustat Company Research, BJ's Wholesale Club Inc, *Company to Industry Comparisons*

<sup>11</sup> Yahoo Finance, Sam's Club, *Company Profile* <http://biz.yahoo.com/ic/56/56161.html>

<sup>12</sup> S&P Net Advantage, BJ's, *Business Summary*

<sup>13</sup> Yahoo Finance, Sam's Club, *Company Profile* <http://biz.yahoo.com/ic/56/56161.html>

<sup>14</sup> S&P Net Advantage, Costco, *Business Summary*

<sup>15</sup> Yahoo Finance, Costco, *Company Profile* <http://finance.yahoo.com/q/pr?s=COST>

<sup>16</sup> BJ's Wholesale Club 2006 Annual Report, *Item 1A. Risk Factors*

profits. On the other hand, if BJ's opens new locations, there is a risk that the locations will not be profitable. The locations would not be profitable if BJ's cannot employ and retain employees or provide competitive prices to customers.

The third risk is that club sales may fluctuate. Club sales may fluctuate due to the opening of new competitor stores or opening of new BJ's clubs in the area. The opening of new BJ's clubs might reduce sales of another BJ's that was already in the area. This might cause price reduction in other BJ's clubs to maintain competition in the current year.

The fourth risk factor is that BJ's is involved in several lawsuits relating to credit fraud, personal injury, and employment issues. For instance, BJ's has outstanding claims of 13 million dollars relating to credit cards as of March 31, 2007, which is .15% of total revenue. If BJ's loses these cases, it will incur material liability, which will negatively impact its financial statements.

The fifth risk that BJ's encounters is regarding insurance claims. Currently, BJ's has insurance for worker's compensation, health costs, and general liability. However, the amount of insurance needed in the current year is determined by the need of such insurance in the past. Thus, if occurrences of insurance claims in the future are greater from the amount in the past, it will negatively impact the operations.

## **V. Growth Strategies<sup>17</sup>**

### *Increasing Number of BJ's Stores*

BJ's goal is to open eight to ten new stores in 2007 and increase advertising tactics. BJ's plans to increase advertising by sending BJ's flyers in the mail, television advertising, radio advertising, create new market programs, and developing a marketing department. Thus, these advertising tactics will increase new memberships and attract new consumers.

### *Increasing Same Store Sales*

BJ's plans to expand through increasing same store sales by offering more competitive prices for products that attract consumers to BJ's and improving their overall price structure. BJ's is committed to expand its organic and perishable food items to insure high quality food for customers. This will allow BJ's to give its customers more choices in food products. BJ's is also expanding its market specialist department in order to create awareness of BJ's to small businesses and corporations. The increase in market specialists will lead to the increase in group membership sales for individual stores.

### *Online Website*

BJ's wants to expand its online website by featuring more products and adding new features to its website. Hence, this will increase online sales due to more product choice. When comparing BJ's current website<sup>18</sup> to Costco's<sup>19</sup>, the website shows that BJ's has less choice and options available on the internet than Costco's for its customers. For instance, Costco's offers flowers and wine online while BJ's does not.

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<sup>17</sup> BJ's Wholesale Club 2006 Annual Report, *Item 1A. Outlook for 2007*

<sup>18</sup> <http://www.bjs.com/>

<sup>19</sup> <http://www.costco.com/Home.aspx>

## VI. Historical Analysis

In broadly reviewing company performance it is apparent that BJ's has been consistently profitable as a corporation and is in good financial standing. However, there are other factors that should be considered in deciding whether to invest in a company. One important measure that can be used is historical stock performance. Over the past five years, stock prices for BJ's have been increasing, with some occasional setbacks.<sup>20</sup> Overall, the pattern of price changes in the company's stock has been very similar to that of both the S&P 500 and the Dow Jones Industrial Average. In the recent past both of these indexes as well as BJ's stock price have shown slight decreases, but over the five year history all have shown an overall increase. The fact that the changes in BJ's stock closely mirror the changes in the overall market would imply that their stock is fairly stable and not likely to have any huge drops in price as long as the U.S. economy is doing well. However, this is usually the case across the retail industry, which relies heavily on the spending habits and disposable income of consumers.

Closing Stock Price	2003	2007	% Increase
BJ's Wholesale Club	\$ 15.40	\$ 31.35	104%
Costco Wholesale Corp	\$ 28.87	\$ 56.01	94%

In viewing the historic stock performance for BJ's, we can see that over the past 5 years the price has more than doubled. At first glance, this 104% increase appears rather large. However, when compared to stock prices for Costco, one of their largest competitors, the growth for BJ's appears somewhat average. Costco's closing stock prices depict a growth of 94% over the same 5 years.

It appears that the stock price growth for BJ's over this period may have more to do with growth of the industry or the entire market than with individual company success. Over the course of this five year period, Total Revenues for BJ's (including membership fees) increased by 44.7%, from \$5.86B to \$8.48B. However, since the company continued to expand operations during this time period from 140 locations to 172, their cost of goods sold and overhead expenses were also greatly increased. This led to a 45% drop in Net Income, from \$130M down to \$72M.

## VII. Operating Capital<sup>21</sup>

While a company's historical performance may be very helpful in analyzing trends and industry patterns, there are many ways to use current statements and figures to determine a company's financial status. By looking at the Net Operating Working Capital that a firm has available we can see the amount of capital supplied by its investors. For BJ's this number has decreased significantly from 2005 to 2006. Costco however has had a large increase in NOWC during this time.

NOWC	2005	2006	% Increase
BJ's Wholesale Club	\$217M	\$146M	-33%
Costco Wholesale Corp	\$651M	\$1.8B	176%

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<sup>20</sup> See Exhibit 1

<sup>21</sup> See Exhibit 2

The Free Cash Flows of a firm are the funds available for distribution, and therefore this calculation plays a large part in determining a company's value in the mind of investors. The FCF calculation consists of the firm's sales revenue less its operating costs, taxes and capital investments. The Free Cash Flows for BJ's for the 2006 fiscal year appear to be in good standing at \$573M, especially when compared to that of Costco. The larger of the two firms actually had negative Free Cash Flows for the fiscal year of over \$1B.

Economic Value and Market Value Added ratios help give us an idea of a firm's managerial effectiveness. Both BJ's and Costco had a negative amount of EVA in 2006, indicating that the management for both companies made few value added decisions during the fiscal year. However, both companies had substantial positive amounts for MVA. This indicates that management has been doing an effective job of building wealth for shareholders since the inception of both firms.

### VIII. Liquidity<sup>22</sup>

In analyzing a firm's liquidity, or its ability to quickly convert assets into cash, we would look mainly at its current assets and liabilities, those that would normally remain on the books for less than a year. When looking at the Current Ratio for BJ's, we see that their Current Assets are 1.23 times their Current Liabilities, whereas Costco has a CA to CL ratio of 1.09. However, once inventories have been removed from the equation, the Quick Ratio of BJ's becomes lower than that of Costco. From this calculation we can see that BJ's inventories take up a larger portion of their Current Assets than those of Costco.

Liquidity	Current Ratio	Quick Ratio
BJ's Wholesale Club	1.23	0.25
Costco Wholesale Corp	1.09	0.52

### IX. Asset Management<sup>23</sup>

Looking at how a firm manages its assets can give potential investors an idea of the company's priorities and whether it is poised for growth. The inventory turnover ratio is a measurement of how many times per year a firm turns its inventory into profits. In the case of BJ's, we see that their inventory turned over at a rate of 9.76 times for this fiscal year, while that of Costco was turned over 12.93 times. Both companies have a similar number of days sale outstanding (BJ's at 4.45 days and Costco at 4.41 days) so both companies usually receive cash from customers after about 4.5 days from the time of sale. Other Asset Turnover ratios give us an idea of how efficiently a firm uses their assets. BJ's had higher Fixed Asset Turnover and Total Asset Turnover rates than Costco. From all of these Asset Management ratios we can see that while BJ's could possibly be more efficient in their inventory purchasing and usage, they otherwise appear to be more efficient in managing their assets than Costco.

Asset Turnover	Inv. Turnover	FA Turnover	TA Turnover
BJ's Wholesale Club	9.76	9.22	4.17
Costco Wholesale Corp	12.93	6.63	3.22

<sup>22</sup> See Exhibit 3a

<sup>23</sup> See Exhibit 3b

## X. Debt Management<sup>24</sup>

One way for firms to fund their operations is through the use of debt. However, firms that take on too much debt are often seen as higher risk investments, as their profits will be used to pay back debt before it is given back to investors. In comparing a firm's Total Liabilities to its Total Assets, we can use this Debt Ratio to determine whether it has taken on too much debt as part of its financing. With a Debt Ratio of 48.82%, BJ's appears to have a fairly normal amount of debt when compared to Costco's debt ratio of 55.66%. By comparing a firm's Earnings before Interest and Taxes to its Interest Expense we can measure its ability to pay interest. In the case of both BJ's and Costco, because their interest payments are fairly low, their Times Interest Earned Ratios of 54.73 and 25.1 are very high.

## XI. Profitability<sup>25</sup>

To analyze the return that a company receives from its operations and investing, we would look at several measures of its profitability. The Profit Margin on Sales, which compares the firm's Net Income to its Sales, measures the percent of profit the firm receives for every dollar of sales. The Profit Margin for BJ's in 2006 was only .87%, compared to a 1.72% return for Costco. The Basic Earning Power for BJ's, or its EBIT compared to its Total Assets, was 7.25%, which was lower than that of Costco at 8.2% but still fairly close. However, in measurements of profitability based on use of assets and capital, (the Return on Assets and Return on Equity) BJ's again came up short when compared to Costco. Although the ROA and ROE for BJ's appear to be fairly low percentages, the company is not necessarily doing poorly. While Costco's ratios are higher than those of BJ's, the numbers are not too far off and are probably within the range of industry standards.

Profitability	ROA	ROE
BJ's Wholesale Club	3.61%	7.06%
Costco Wholesale Corp	5.52%	12.56%

It appears from this set of ratios that BJ's did not convert as much of its sales to profit as Costco, and because BJ's had a negative investment in operating capital, it doesn't appear that the decrease in profits was from investing. However there could be other factors that are contributing to the firm's low profit margin, such as the increase in their cost of sales.

## XII. Market Value<sup>26</sup>

While you can use a firm's financial reports to determine its book value, this does not always give a clear picture of its status in the market. Factors such as the market price of the stock and also the market value of the overall company can provide better insight on the performance and market perception of the firm. Aside from per-share price, another way to determine the value of the company's stock is through its

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<sup>24</sup> See Exhibit 3c

<sup>25</sup> See Exhibit 3d

<sup>26</sup> See Exhibit 3e



Price/Earnings ratio. In finding the P/E ratio for the 2006 fiscal year, this ratio compares the year end closing price of a stock to its Earnings Per Share ratio, and gives potential investors an idea of the earnings growth they can expect from the company's stock.

Market Value	EPS	P/E Ratio	Price/Cash Flow	Market/Book Value
BJ's Wholesale Club	1.10	28.53	11.59	2.01x
Costco Wholesale Corp	2.42	25.53	16.76	3.21x

In 2006 BJ's had an EPS ratio that was less than half of that of Costco. However, because of Costco's relatively higher stock price, the two companies have fairly close Price/Earnings ratios. The P/E ratio for BJ's is slightly higher than that of Costco at, indicating that regardless of their disparate prices, the stock of each of these companies is a similarly good investment. By comparing the price of the stock to its calculated cash flow per share we create a multiplier that estimates how much an investor would be willing to pay for each dollar of cash flow provided by the firm. The Price to Cash Flow ratio for BJ's is slightly lower than that of Costco, indicating that investors would be willing to pay more to invest in Costco.

A comparison of the Market and Book Values of the firm's stock can also be used to determine how investors value the company. By dividing the market price per share of stock by the book value per share, we create a multiplier which estimates how much an investor would be willing to pay for each dollar of book value. Again, BJ's has a lower multiplier at 2.01 compared with 3.21 for Costco. The DuPont System allows us to break down Return on Equity into three parts that each give us some insight into the workings of the business. With these pieces we can analyze the firm's efficiency in expense control, asset consumption and use of debt, and see how each contributes to ROE.

DuPont System	Profit Margin	x	TA Turnover	x	Equity Multiplier	=	ROE
BJ's Wholesale Club	0.87%	x	4.17	x	1.95	=	7.06%
Costco Wholesale Corp	1.72%	x	3.22	x	2.27	=	12.56%

While BJ's had a greater rate of asset turnover than Costco in the fiscal year, Costco had greater profit margins and a higher equity multiplier, and was therefore able to build a greater return on its overall equity. Overall, these ratios give a favorable picture of the current fiscal status of BJ's. While the company is not leading its competition in many categories, it still manages to be closely competitive, especially when considering its relative size.

### XIII. Current Stock Price Analysis <sup>27</sup>

Since the close of the BJ's 2006 fiscal year (February 3, 2007), their share price has continued to rise. In about 14 months the closing price has increased by \$3.49, or 11.1% of the stock price. Since Costco's 2006 fiscal year close (September 3, 2007) their share price has also continued to rise, and in less than 7 months the price has increased by \$2.62, or 4.2% of the stock price. On the closing date of BJ's fiscal year, the stock price

<sup>27</sup> See Exhibit 4

for Costco was \$56.01, which means that over the same 14 month period Costco's shares saw a price increase of \$8.36, or 14.9%.

It was previously stated that stock prices for both BJ's and Costco seemed to move in a pattern similar to that of the overall market for the 5 years prior to the 2006 fiscal year close. However, the stock price for BJ's does not appear to be following some of the more recent drastic market fluctuations. Beginning in December of 2007 through January of 2008 the stock price fell by approximately \$10. This may have had more to do with analyst predictions of a poor retail season than actual sales or earnings results, as all results announced in December and January for the company had positive increases over the previous year. The stock price has since begun to increase, while both the DJIA and S&P 500 have been slowly but steadily declining.

As of March 28, 2008	Price	Increase since 2/3/07	% Increase
BJ's Wholesale Club	\$34.84	\$3.49	11.1%
Costco Wholesale Corp	\$64.37	\$8.36	14.9%

#### **XIV. Growth Rate**

##### *Sustainable Growth Rate<sup>28</sup>*

The sustainable growth rate for BJ's for the year ended 2007, 2006, and 2005 is respectively 7.06%, 12.65%, and 12.18%. The figures show that the growth rate for 2007 decreased significantly, almost by half of the percentage points. The decrease in the sustainable growth rate is due to the decrease in net income for BJ's in 2007. Through further analysis, the 2007 cash flow statement reveals that BJ's significantly increased their capital expenditures and investments. The increase in cash outflow in investing activities caused the decline in net income. Thus, in order to increase the sustainable growth rate in the future, BJ's needs to decrease cash spent in capital expenditure or restructure spending in investing activities.

Furthermore, BJ's has paid very little in dividends in the history of the company. Since 1997 they have paid only \$25k per year to the preferred shareholders of one of their subsidiaries, and no dividends to any other shareholders. Thus, when calculating the sustainable growth rate, the dividends paid to the preferred stockholders in the previous years was used. Holders of the company's common stock are not entitled to dividends, and while BJ's has authorized 20 million shares of preferred stock they have yet to issue any of these and do not intend to do so any time in the near future. BJ's should continue with minor expansion plans of a few locations a year. They should be able to do so without lowering their sustainable growth rate by a large amount.

	2007	2006	2005
Sustainable Growth Rate	7.06%	12.65%	12.18%

##### *Actual Sales Growth<sup>29</sup>*

In looking at the sales figures for BJ's over the last 3 years reported, we can see that the rate of actual sales growth has been declining steadily. As of the end of 2006

<sup>28</sup> See Exhibit 5

<sup>29</sup> See Exhibit 6

however, the sales growth rate still was slightly above the firm's sustainable growth rate. It would appear that the high growth of the 2004 fiscal year was unusual and the firm took measures to return to a normalized rate of growth. These measures could include the continuing expansion that BJ's has been working on over the past few years. However, when forecasting sales growth, it is necessary to take the average sales growth rate to predict future growth. As a result, after averaging the previous actual sales growth rates, the sales growth rate for 2007-2008 is 8.21%. Relatively, the predicted five year sales growth rate for BJ's is 8.97%<sup>30</sup>, which is much higher than the expected growth rate for 2007-2008. The sales growth of 8.21% will cause net sales to be \$8,985,213 for 2007-2008.

	2008-2007E	2007-2006	2006-2005	2004-2005
Change in Sales (%)	8.21%	7.17%	7.38%	10.10%

	2007E	2006	2005	2004
Net Sales	\$8,985,213	\$8,303,496	\$7,748,184	\$7,215,968

#### XV. Capital Asset Pricing Model (CAPM)<sup>31</sup>

CAPM is one approach to determining the cost of common stock. Using the values for beta, the market risk premium, and the risk free rate listed below, the cost of common stock for BJ's comes to 13.02%. This is the rate of return that is required by BJ's stockholders. Additionally, if BJ's can not earn at least 13.02% on reinvested earnings, then the company should pass the earnings on to its stockholders.<sup>32</sup> For this scenario, one thing to keep in mind is that, "BJ's has never declared or paid any cash dividends on its common stock and has no present plans to do so."<sup>33</sup>

<b>Beta for BJ's</b>	1.5019
<b>Market Risk Premium (RP<sub>M</sub>)</b>	5.75%
<b>Risk Free Rate (r<sub>RF</sub>)</b>	4.38%
<b>Required Rate of Return for BJ's (r<sub>s</sub>)</b>	13.02%

#### XVI. Weighted Average Cost of Capital (WACC)<sup>34</sup>

The weighted average cost of capital depicts the capital structure of a company. Companies use different target structures in order to minimize weighted average cost of capital. BJ's capital structure is constructed in a manner where 99.87% of its capital originates from common stock while .13% is obtained from debt. BJ's does not use preferred stock as a means of creating capital since it does not issue any preferred stock. As a result, BJ's weighted average cost of capital is 13.01%. This denotes that the overall required rate of return for BJ's as a whole is 13.01%

<sup>30</sup> Reuters, <http://stocks.us.reuters.com/stocks/ratios.asp?symbol=BJ>

<sup>31</sup> See Exhibit 7

<sup>32</sup> Brigham, Eugene F. and Ehrhardt, Michael C., *Financial Management Theory and Practice, Cost of Common Stock*, pg. 346

<sup>33</sup> BJ's Wholesale Club 2006 Annual Report, *Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities*

<sup>34</sup> See Exhibit 8

Capital Source	Weight of Capital in %
Common Stock	99.87%
Debt	0.13%

Weighted Average Cost of Capital	13.01%
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## XVII. Expected Price of Stock

### *Earnings per Share (EPS)*<sup>35</sup>:

As stated above, BJ's has not paid dividends on its common stock and does not plan on paying them in the future. Therefore, EPS has been used rather than dividends in the dividend growth model to calculate the expected price of BJ's stock. The chart below includes the expected prices that have been calculated for BJ's using this method. These expected prices are the intrinsic value of the stock as seen by the investor preparing this analysis. These values can differ depending on the investor and his or her assumptions. An investor would only purchase BJ's stock if his/her estimate of the company's expected stock price today is greater or equal to the actual market price of the stock today<sup>36</sup>. The actual current stock price for BJ's is \$34.84 (as of 3/28/08). Therefore, an investor should not invest in BJ's if they come up with the expected price for today that is listed below. However, the investor may also want to revisit his/her approach for this calculation and any assumptions made prior to making this decision.

Expected Price Today ( $P_0$ )	\$ 14.64
Expected Price One Year from Now ( $P_1$ )	\$ 15.39
Expected Price Two Years from Now ( $P_2$ )	\$ 16.18

### *Free Cash Flows*<sup>37</sup>

We can use the projected Free Cash Flows of the firm to determine the intrinsic value of its stock, or the expected dividend stream of the stock. Based on \$573 M in Free Cash Flows for 2006 at a growth rate of 8.21% the value of operations for BJ's is approximately \$12.9B. When the firm's debt is subtracted, and we divide by the number of shares, the stock for BJ's has an intrinsic value per share of \$197. From this we can infer that the low levels of long-term debt that BJ's employs, combined with their reluctance to issue preferred stock dividends, have led to high expected returns over the life of the stock.

### *Market Multiples*<sup>38</sup>

An alternative method to calculate the value of a company's expected stock price is through market multiple analysis. Market multiple analysis gives a "more judgmental" valuation of the stock price. The expected price of BJ's stock using market multiple

<sup>35</sup> See Exhibit 9

<sup>36</sup> Brigham, Eugene F. and Ehrhardt, Michael C., Financial Management Theory and Practice, *Common Stock Valuation*, pg. 285

<sup>37</sup> See Exhibit 10

<sup>38</sup> See Exhibit 11

analysis is \$30.39. The reduction in the price of BJ's stock results because Costco's price per earnings ratio was used as a market multiple. Costco has a lower price per earnings ratio than BJ's. Thus, this causes the price of stock to be lower when using market multiple analysis to calculate BJ's expected stock price.

<b>Expected Price of BJ's Stock</b>	<b>\$ 30.39</b>
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We support the market multiple methodology as it yields the closest expected price of BJ's stock to the actual market price. Because BJ's did not pay common stock dividends and had low values for preferred stock dividends, this likely contributed to the expected stock price being less accurate when calculated using the dividend growth and free cash flow models.

## **XVIII. Scenario Analysis**

### *Economic Forecast*

We have forecasted a 50% probability of the economy improving through the end of 2008. One reason for this is the upcoming presidential election. "The market has posted gains 80% of the time in presidential election years."<sup>39</sup> Looking at the S&P 500 index specifically, it has had good performance during presidential election years, rising 8.6% on average since 1945.<sup>40</sup> The last year of a presidential term may tend to improve the economy because the current elected political party likely wants to provide reasons for American citizens to re-elect the political party. For example, this year President Bush implemented an economic stimulus package to help "jump start" the economy. This package includes provisions to help spur business investment and consumer spending.<sup>41</sup> Another reason to believe that the economy may improve through the end of 2008 is Standard & Poor's forecast of the economy growing at a higher rate over the second half of 2008 versus the first half (annual projected growth rates of 2.5% and 1.3%, respectively, were provided).<sup>42</sup>

On the flip side, we are forecasting a 50% probability of a decline in the economy through the end of 2008. We feel that the reasons supporting a decline in the economy are as equally compelling as those supporting an improvement in the economy through the end of 2008. Reasons supporting a decline in the economy include the "credit crunch", the housing burst<sup>43</sup>, the increase of unemployment<sup>44</sup>, and the decline in consumer spending, which we believe are all likely to continue in 2008. Even though President Bush has created the economic stimulus package, many consumers may still hold off on significant spending on products that are not necessities because of the unstable economic condition. Standard & Poor's predicted that consumer spending will

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<sup>39</sup> Standard & Poor's 2008 Annual Forecast, December 19, 2007, *2008 Election Outlook*

<sup>40</sup> Standard & Poor's 2008 Annual Forecast, December 19, 2007, *2008 Election Outlook*

<sup>41</sup> Fact Sheet: New Growth Package Meets Criteria to Keep Our Economy Healthy, January 24, 2008  
<http://www.whitehouse.gov/news/releases/2008/01/20080124-4.html>

<sup>42</sup> Standard & Poor's 2008 Annual Forecast, December 19, 2007, *Tougher Times Ahead*

<sup>43</sup> Wachovia Economics Group Monthly Outlook, March 12, 2008, *US Outlook*: "The housing market has not bottomed out yet."

<sup>44</sup> Standard & Poor's 2008 Annual Forecast, December 19, 2007, *Tougher Times Ahead*: "We expect the unemployment rate to climb to 5.2% in the third quarter of 2008 from the expected 4.7% at year-end 2007."

“slow to 1.8% in 2008 from an expected 2.8% in 2007”<sup>45</sup> and we are only three months into the year. However, it is important to note that this prediction was made in December 2007 (prior to the economic stimulus package being signed by President Bush).

Finally, we have forecasted a 0% chance that the economy will stay the same through the end of 2008. The economy will not remain stagnant because of the reasons mentioned above, including the presidential election, the increase in unemployment, and the credit crunch. Thus we believe that the economy will either improve or worsen, but not stay the same.

<b>Up</b>	50%
<b>Same</b>	0%
<b>Down</b>	50%

### *BJ's Return Predictions*

The performance of BJ's in the above economic forecast is dependent on its beta. The beta is an indicator of how a company will respond to the condition of the market. As noted before, BJ's has a beta of 1.50. This means that BJ's will be more volatile in the market since beta is higher than 1. Hence, with the given economic forecast, if the economy improves BJ's will improve its return 1.50 times the percent increase in the market. For example, if the economic market increases by 10%, BJ's returns will increase by 15%. Similarly if the economy worsens, BJ's will decrease its return 1.50 times the percent decrease in the market. For instance, if the economic market decreases by 20%, BJ's returns will decrease by 30%. Thus, BJ's return in the given economic forecast is dependent on its beta value.

<b>% Increase or Decrease</b>	<b>BJ's Predicted Returns</b>
10% increase	15% increase
15% increase	22.5% increase
5% decrease	7.5% decrease
20% decrease	30% decrease

### **XIX. Cash Conversion Cycle<sup>46</sup>**

The cash conversion cycle depicts the length of time between a firm's "cash expenditures to pay for productive resources and its own cash receipts from the sale of product"<sup>47</sup>. For the past three years, BJ's cash conversion period has been increasing (see below). Furthermore, Costco's cash conversion period is significantly lower than that of BJ's. The significant difference between the two companies requires examination of the days inventory held ratio as well as the days payable outstanding.

After examining the above ratios, there are two recommendations that BJ's should consider. One strategy that BJ's can implement to lower the cash conversion period is to reduce the amount of inventory held. This will free some of the cash tied up in inventory

<sup>45</sup> Standard & Poor's 2008 Annual Forecast, December 19, 2007, *Tougher Times Ahead*

<sup>46</sup> See Exhibit 12

<sup>47</sup> Brigham, Eugene F. and Ehrhardt, Michael C., *Financial Management Theory and Practice, Cash Conversion Cycle*, pg. 777

and allow BJ's to use this cash for future investments. Also, BJ's days inventory held ratio is higher than Costco on average by 10 days. As a result, reducing the amount of inventory will help decrease the cash conversion cycle and create efficient use of cash. Another strategy that BJ's should implement is to make slower payments to suppliers. On average, BJ's pays suppliers about 5 to 6 days earlier than Costco. Making slower payments will decrease the number of days in the cash conversion period. Thus, if BJ's incorporates the above recommendations the firm will gain efficiency in its use of cash, similar to that of its competitor.

Cash Conversion Period	BJ's	Costco
Year Ended 2007	15.03	-0.50
Year Ended 2006	14.39	0.03
Year Ended 2005	13.40	-1.30

## XX. Management Recommendations

In addition to the recommendations provided in the Cash Conversion Cycle section directly above, there are a number of other management recommendations for consideration. They are as follows:

1) Given the decrease in BJ's sustainable grown rate from 2006 to 2007 as discussed above, BJ's should continue with expansion plans on a small scale. BJ's should review their sustainable growth rate at least yearly in the future to help decide how many new stores to open going forward.

2) BJ's should begin to expand westward in the U.S. and also into international markets in order to gain more market share and become more competitive with Costco & Sam's Club. Per Wikinvest, Costco had 54% of the wholesale club market share, Sam's Club had 38%, and BJ's had only 8% in 2006.<sup>48</sup> Both Costco and Sam's Club have stores located worldwide, while BJ's only has stores in the eastern U.S. This likely contributes to the competitors having higher market share than BJ's. Additionally, Costco and Sam's Club have many more stores than BJ's, which is another factor explaining their higher market share.<sup>49</sup>

3) As discussed in section XI. Profitability, BJ's lags behind Costco when looking at profitability ratios such as Profit Margin on Sales, ROA, ROE, etc. BJ's should examine its larger expenses outside of investing in new stores to see if any can be decreased. Decreasing expenses could help increase BJ's net income, which would then potentially improve its profitability ratios.

4) Another way to increase profitability and sales growth is to increase net sales. BJ's sales growth has been declining steadily over the last three years. This could be partially addressed by BJ's opening new stores. BJ's should also continue with their marketing efforts (including advertising and promotions) to attempt to gain new customers, keep their existing customers, and increase sales.

5) BJ's should consider re-weighting their capital structure given that the cost of capital for debt (4.34%) is lower than their cost of capital for equity (13.02%). BJ's has significantly over-weighted common stock (99.97%) versus debt (.13%). However, BJ's

<sup>48</sup> Wikinvest, BJ's Wholesale Club, *Market Share* <http://www.wikinvest.com/>

<sup>49</sup> Refer to section III. Competitors for more information.

should probably make moderate capital structure changes and monitor the price of the stock in the market and its beta value as the more debt a company accumulates, the more risk investors can associate with the stock<sup>50</sup>. Increasing the weight of debt should decrease BJ's weighted average cost of capital, which would then improve market value added (MVA).<sup>51 52</sup>

6) BJ's should attempt to become more efficient in their inventory turnover and usage per the Asset Management section (IX.) above. In order to do this, BJ's purchasing process should be examined. Those items that sit on the shelf the longest should probably be purchased in smaller quantities. This will also decrease the risk of items passing their shelf life prior to being purchased.

### **XXI. Analyst Ratings**

The following Analyst ratings have been published for BJ's stock (all were extracted on 4/22/08). Based on these ratings and the above analysis, we have rated BJ's as a Hold<sup>53</sup>. BJ's has been consistently profitable as a corporation, is in good financial standing, and is comparable with Costco (one of its top competitors) for some financial measures and ratios. However, BJ's also has various areas for improvement, including those described in the Management Recommendations section (XVIV). Another consideration is that BJ's stock price has had some notable fluctuation since December 2007 and is now on the higher end since that time.<sup>54</sup> We believe that it would be better to wait for a future dip in BJ's stock price prior to buying into it, which we think will likely occur at some point in the next six months with the current state of the economy. We also feel that in the future over the longer term BJ's stock prices will continue to rise. Therefore, shareholders selling out of the stock now will likely be missing out on greater returns on their investment.

<b>Source</b>	<b>Rating</b>
Standard & Poor's <sup>55</sup>	Buy
Reuters <sup>56</sup>	Hold
Yahoo Finance <sup>57</sup>	~ Hold
Thomson ONE Banker <sup>58</sup>	~ Hold

<sup>50</sup> Assuming all other considerations stay the same.

<sup>51</sup> See Exhibit 8.

<sup>52</sup> This assumes that the cost of capital does not decrease and the cost of debt does not increase significantly in the next couple of years.

<sup>53</sup> This rating is for educational purposes only.

<sup>54</sup> See Exhibit 4.

<sup>55</sup> S&P Stock Report for BJ's Wholesale Club Inc., 4/19/2008, *S&P Recommendation*

<sup>56</sup> Reuters, BJ's Wholesale Club Inc., 4/18/2008, *Recommendations*

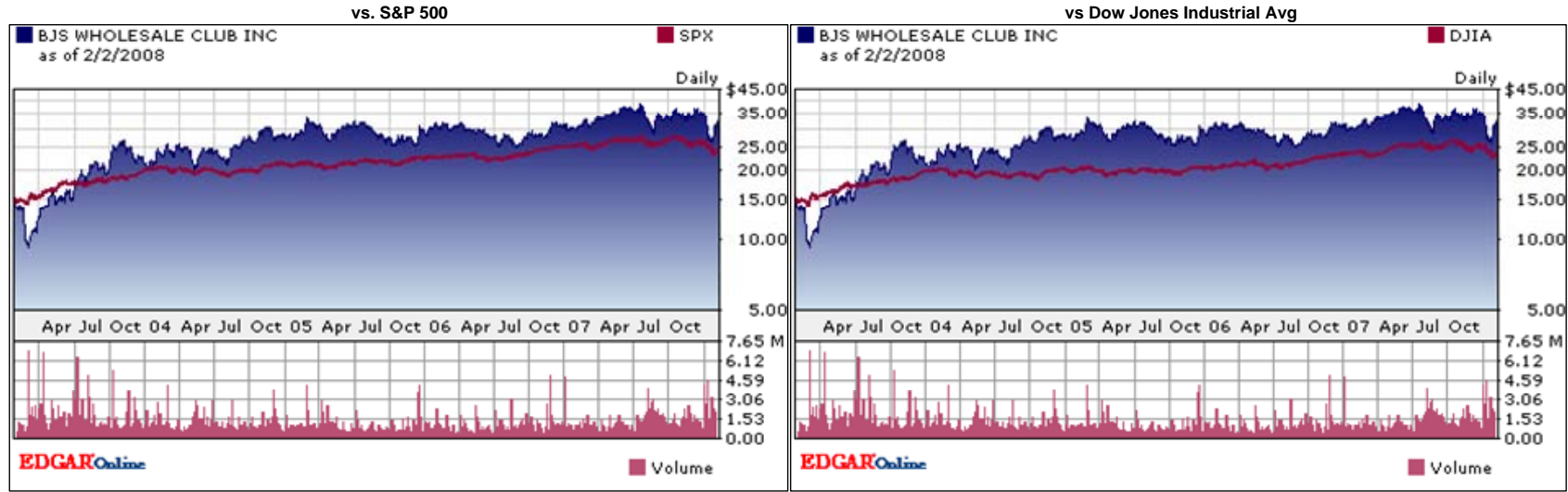
<sup>57</sup> Yahoo Finance, BJ's Wholesale Club Inc, *Analyst Opinion*, mean recommendation week of 4/21/2008 was 2.8 on a scale of 1.0 (Strong buy) to 5.0 (Sell)

<sup>58</sup> Thomson ONE Banker, BJ's Wholesale Club Inc, *Analyst Rating*, rating slightly beyond the middle of range (towards the Strong buy side) on a scale of Sell to Strong Buy, extracted on 4/22/08



Historical Stock Price Comparison (Exhibit 1)

BJ's Wholesale Club Inc - 5 Year Historical Price Charts



Costco Wholesale Corp - 5 Year Historical Price Charts



**Working Capital & Value Added (Exhibit 2)\***

		BJs			
		Year Ended 2/3/2007		Year Ended 1/28/06	
		Calculation	Value	Calculation	Value
Op CA	Cash + Inv + AR	55877+850902+101292	\$ 1,008,071	162164+101435+813270	\$ 1,076,869
Op CL	AP + Accruals*	560406+266864+34626	\$ 861,896	555968+252575+51568	\$ 860,111
NOWC	Op CA - Op CL	1008071-861896	\$ 146,175	1076869-860111	\$ 216,758
Net Op Cap	NOWC + FA	146175+900148	\$ 1,046,323	216758+1313533	\$ 1,530,291
NOPAT	EBIT (1-tax rate)	144383*(1-0.38)	\$ 89,517		
	Net Investment In Op Cap	1046323-1530291	\$ (483,968)		
FCF	NOPAT - Net Invest. in OpCap	89517- (-483968)	\$ 573,485		
ROIC	NOPAT / Op Cap	89517/1046323	8.56%		
EVA	NOPAT - (WACC)(Capital)*	89517-(0.1*1046323)	(15,114.84)		
Market Value	Shares Out * Price/Share	65530*31.35	\$ 2,054,366		
Book Value	TCE	\$ 1,019,887	\$ 1,019,887		
MVA	Market Value - Book Value	2054366-1019887	\$ 1,034,479		

		Costco			
		Year Ended 9/2/07		Year Ended 9/3/06	
		Calculation	Value	Calculation	Value
Op CA	Cash + Inv + AR	2779733+4879465+762017	\$ 8,421,215	1510939+565373+4561232	\$ 6,637,544
Op CL	AP + Accruals	5124990+1226666+267920	\$ 6,619,576	4581395+1080382+324274	\$ 5,986,051
NOWC	Op CA - Op CL	8421215-6619576	\$ 1,801,639	6637544-5986051	\$ 651,493
Net Op Cap	NOWC + FA	1801639+9519780	\$ 11,321,419	651492+8564295	\$ 9,215,788
NOPAT	EBIT (1-tax rate)	1608586*(1-0.368)	\$ 1,016,626		
	Net Investment In Op Cap	11321419-9215787	\$ 2,105,631		
FCF	NOPAT - Net Invest. in OpCap	1016626-2105632	\$ (1,089,005)		
ROIC	NOPAT / Op Cap	1016626/11321419	8.98%		
EVA	NOPAT - (WACC)(Capital)*	1016626-(0.1*11321419)	(115,515.55)		
Market Value	Shares Out x Price/Share	447659*61.75	\$ 27,642,943		
Book Value	TCE	\$ 8,623,341	\$ 8,623,341		
MVA	Market Value - Book Value*	27642943-8623341	\$ 19,019,602		

**Assumptions:**

\*All dollar amounts and shares outstanding numbers in thousands

\*Assuming accrued sales and other taxes are included in accruals

\*WACC assumed at 10%

\*Assuming Market Value of Debt = Book Value of Debt

**Ratio Analysis (Exhibit 3a-3e)\***

		BJs		Costco	
		Year Ended 2/3/07		Year Ended 9/3/07	
		Calculation	Value	Calculation	Value
<b>Liquidity Ratios (Exhibit 3a)</b>					
Current Ratio	Current Assets	\$ 1,069,578	\$ 1,069,578	\$ 9,324,153	\$ 9,324,153
	Current Liabilities	\$ 866,578	\$ 866,578	\$ 8,581,753	\$ 8,581,753
	CA/CL	1069578/866578	1.23	9324153/8581753	1.09
Quick Ratio	Inventories	\$ 850,902	\$ 850,902	\$ 4,879,465	\$ 4,879,465
	(CA-Inv.)/CL	(1069578-850902)/866578	0.25	(9324153-4879465)/8581753	0.52
<b>Asset Management (Exhibit 3b)</b>					
Inventory Turnover	Sales*	\$ 8,303,496	\$ 8,303,496	\$ 63,087,601	\$ 63,087,601
	Inv	\$ 850,902	\$ 850,902	\$ 4,879,465	\$ 4,879,465
	Sales/Inv	8303496/850902	9.76	63087601/4879465	12.93
Days Sales Outstanding	Receivables	\$ 101,292	\$ 101,292	\$ 762,017	\$ 762,017
	Receivables/(Sales/365)	101292/(8303496/365)	4.45	762017/(63087601/365)	4.41
Fixed Asset Turnover	Net FA*	\$ 900,148	\$ 900,148	\$ 9,519,780	\$ 9,519,780
	Sales/Net FA	8303496/900148	9.22	63087601/9519780	6.63
Total Asset Turnover	TA	\$ 1,992,811	\$ 1,992,811	\$ 19,606,586	\$ 19,606,586
	Sales/TA	8303496/1992811	4.17	63087601/19606586	3.22
<b>Debt Management (Exhibit 3c)</b>					
Debt Ratio	TL	\$ 972,924	\$ 972,924	\$ 10,913,928	\$ 10,913,928
	TL/TA	972924/1991811	48.82%	10913928/19606586	55.66%
TIE	EBIT	\$ 144,383	\$ 144,383	\$ 1,608,586	\$ 1,608,586
	Interest Expense	\$ 2,638	\$ 2,638	\$ 64,079	\$ 64,079
	EBIT/Interest Expense	144383/2638	54.73	1608586/64079	25.10
EBITDA	Rent*	\$ 131,725	\$ 131,725	\$ 143,448	\$ 143,448
	Loan*	\$ -	\$ -	\$ -	\$ -
	EBIT + Depreciation + Rent	144383+105253+131725	\$ 381,361	1608586+566385+143448	\$ 2,318,419
	Int Expense + Rent + Loan Pmt	2638+131725+0	\$ 134,363	64079+143448+0	\$ 207,527
	EBITDA	381361/134363	2.84	2318419/207527	11.17

		BJs		Costco	
		Year Ended 2/3/07		Year Ended 9/3/07	
		Calculation	Value	Calculation	Value
<b>Profitability (Exhibit 3d)</b>					
	NI	\$ 72,016	\$ 72,016	\$ 1,082,772	\$ 1,082,772
Profit Margin on Sales	NI/Sales	72016/8303496	0.87%	1082772/63087601	1.72%
Basic Earning Power	EBIT/TA	144383/1992811	7.25%	1608586/19606586	8.20%
Return on Assets	NI/TA	72016/1992811	3.61%	1082772/19606586	5.52%
	Common Equity	\$ 1,019,887	\$ 1,019,887	\$ 8,623,341	\$ 8,623,341
ROE	NI/CE	72016/1019887	7.06%	1082772/8623341	12.56%

<b>Market Value Ratios (Exhibit 3e)</b>					
	Shares Outstanding*	65,530	65,530	447,659	447,659
Earnings Per Share	NI/Shares Outstanding	72016/65530	1.10	1082772/447659	2.42
	Price/Share*	\$ 31.35	\$ 31.35	\$ 61.75	\$ 61.75
Price/Earnings Ratio	Price/Share / EPS	31.35/1.1	28.53	61.75/2.42	25.53
	Depreciation*	\$ 105,253	\$ 105,253	\$ 566,385	\$ 566,385
Cash Flow Per Share	(NI+Depr)/Shares Out	(72016+105253)/65530	2.71	(1082772+566385)/447659	3.68
Price/Cash Flow	Price/Share / CF/Share	31.35/2.71	11.59	61.75/3.68	16.76
Book Value Per Share	Common Equity/Shares Out	1019887/65530	\$ 15.56	8623341/447659	\$ 19.26
Market/Book Ratio	Price/Share/Book Value/Share	31.35/15.56	2.01	61.75/19.26	3.21
DuPont System	NI/Sales x Sales/TA x TA/CE	0.0087*4.17*1.95	7.06%	0.0172*3.22*2.27	12.56%
Profit Margin	NI/Sales	0.87%	0.87%	1.72%	1.72%
TA Turnover	Sales/TA	4.17	4.17	3.22	3.22
Equity Multiplier	TA/CE	1992811/1019887	1.95	19606586/8623341	2.27

Assumptions:

\*All dollar amounts and shares outstanding numbers in thousands

\*Sales for both companies exclude membership fees

\*Net Receivables used in calculation of Fixed Assets

\*Rent Expense was used for Lease Payment

\*Assumed \$0 for Loan Payment

\*Per share prices are closing prices for last trading day of fiscal year (BJs closing price February 3, 2007, Costco closing price September 2, 2007)

\*Assume weighted average shares outstanding. Costco shares outstanding taken from September 2, 2007

Changes in Stock Price Since 2/3/07 (Exhibit 4)

vs. S&P 500

■ BJS WHOLESALE CLUB INC  
as of 4/1/2008

■ SPX



vs S&P 500

■ COSTCO WHSL CORP NEW  
as of 4/1/2008

■ SPX



**Sustainable Growth Rate (Exhibit 5)**

	2007	2006	2005
Net Income	\$72,016.00	\$128,533.00	\$114,401
Common Equity	\$1,019,887.00	\$1,015,979.00	\$939,167
Dividends Paid*	\$25.00	\$25.00	\$25.00

	Calculation	Value
BJ's <sub>2007</sub> ROE	72016 / 1019887	7.06%
BJ's <sub>2007</sub> Payout Ratio	25 / 72016	0.03%
BJ's <sub>RetentionRate</sub>	1-(25 / 72016)	0.9997
BJ's <sub>g*2007</sub>	[1-(25 / 72016)] * (72016 / 1019887)	7.06%

BJ's <sub>2006</sub> ROE	128533 / 1015979	12.65%
BJ's <sub>2006</sub> Payout Ratio	25 / 128533	0.02%
BJ's <sub>RetentionRate</sub>	1-(25 / 128533)	0.9998
BJ's <sub>g*2006</sub>	[1-(25 / 128533)] * (128533 / 1015979)	12.65%

BJ's <sub>2005</sub> ROE	114401 / 939167	12.18%
BJ's <sub>2005</sub> Payout Ratio	25 / 114401	0.02%
BJ's <sub>RetentionRate</sub>	1-(25 / 114401)	0.9998
BJ's <sub>g*2005</sub>	[1-(25 / 114401)] * (114401 / 939167)	12.18%

Assumptions:

\*Preferred Stock Dividends

**Sales Growth Rate Estimate (Exhibit 6)**

	2/3/2007	1/28/2006	1/29/2005	1/31/2004
Net Sales*	\$ 8,303,496	\$ 7,748,184	\$ 7,215,968	\$ 6,553,924
Change in Sales Calculation	(8303496 - 7748184) / 7748184	(7748184 - 7215968) / 7215968	(7215968 - 6553924) / 6553924	-
Change in Sales (%)	7.17%	7.38%	10.10%	-
Average Sales	(7.17+7.38+10.10) / 3			
Average Sales Growth	8.21%			
Projected Net Sales	8303496* (1+.0821)			
Projected Net Sales	\$8,985,213			

Assumptions:

\*Excludes Membership Sales

\*Net Sales in Thousands

## Capital Asset Pricing Model (Exhibit 7)

	Formula	Calculation	Value
Beta for BJs (b)*			1.5019
Market Risk Premium (RPM)*			5.75%
Risk Free Rate (r <sub>RF</sub> )*			4.38%
Required Rate of Return for BJ's (r <sub>s</sub> )	$r_{RF} + (r_M - r_{RF})b = r_{RF} + (RPM)b$	4.38%+(5.75%*1.5019)	13.02%

Assumptions/Data Sources:

\*Beta from S&P Net Advantage, extracted on 3/29/08

\*R<sub>PM</sub> average of 5% and 6.5%, as most analysts use a rate between the two for this value per Chapter 10 slides

\*For r<sub>RF</sub> utilized the 30 Year T-Bond rate provided by the Financial Forecast Center (<http://www.forecasts.org/30yrT.htm>) as of March 28, 2008 (Close of Day)

### Weighted Average Cost of Capital (WACC) (Exhibit 8)

Corporate Tax Rate:		38%
LT Debt Int. Rate ( $r_d$ )		7%
Stock Price*	\$	31.35
Shares Outstanding*		65,530
Total Common Stock		2,054,366

### Capital Structure (in thousands)

Capital Source	Amount	Calculation of Weight of Capital	Weight of Capital in %	Calculation of Cost of Capital	Value of Cost of Capital
Common Stock	\$ 2,054,366	$\$2,054,366/\$2,057,102$	99.87%	13.02%*	13.02%
Debt*	\$ 2,736	$\$2,736/\$2,057,102$	0.13%	.07(1-.38)	4.34%
<b>Total Value</b>	<b>\$ 2,057,102</b>				

WACC	Calculation	Value
	$(.9987*.1302)+(.0013*.0434)$	13.01%

#### Assumptions:

- \*return on equity was used from CAPM calculation
- \* Interest rate on the long term debt was obtained from page 39 of BJ's 10K
- \*Current Installments of Long Term Debt was used for Long Term Debt Calculation
- \*Long-term Debt, less portion due within one year was used for Long Term Debt Calculation
- \*Per share prices are closing prices for last trading day of fiscal year (BJs closing price February 3, 2007)
- \*used weighted average shares outstanding
- \*assuming no preferred stock



### Expected Price of Stock based on EPS ( Exhibit 9)

		Calculation	Value
Retained Earnings (as of 2/3/07)			1,158,137,000
Retained Earnings (as of 1/28/06)			1,105,913,000
Net Income (year ending 2/3/07)			72,016,000
Return on Equity (ROE) (year ending 2/3/07)		see Exhibit 3	7.06%
Retention Rate*	(Retained Earnings 2007 - Retained Earnings 2006)/Net Income 2007	$(1,158,137,000 - 1,105,913,000) / 72,016,000$	72.52%
Expected Growth Rate (g)	ROE * Retention Rate	$7.06\% * 72.52\%$	5.12%
Required Rate of Return for BJ's ( $r_s$ )		see Exhibit 7	13.02%
EPS <sub>0</sub> (year ending 2/3/07)		see Exhibit 3	1.1
EPS <sub>1</sub>	EPS <sub>0</sub> (1 + g)	$1.1(1 + 5.12\%)$	1.16
EPS <sub>2</sub>	EPS <sub>1</sub> (1 + g)	$1.16(1 + 5.12\%)$	1.22
EPS <sub>3</sub>	EPS <sub>2</sub> (1 + g)	$1.22(1 + 5.12\%)$	1.28
Expected Price Today (P <sub>0</sub> *)	EPS <sub>1</sub> /( $r_s - g$ )	$1.16 / (13.02\% - 5.12\%)$	14.64
Expected Price One Year from Now (P <sub>1</sub> *)	EPS <sub>2</sub> /( $r_s - g$ )	$1.22 / (13.02\% - 5.12\%)$	15.39
Expected Price Two Years from Now (P <sub>2</sub> *)	EPS <sub>3</sub> /( $r_s - g$ )	$1.28 / (13.02\% - 5.12\%)$	16.18

#### Assumptions:

\*Retention Rate is retained earnings divided by total after-tax earnings (assuming that after tax earnings also excludes interest). Definition from Investor Words website:

[http://www.investorwords.com/4238/retention\\_rate.html](http://www.investorwords.com/4238/retention_rate.html)

\*EPS is being used rather than dividends as, "BJ's has never declared or paid any cash dividends on its common stock and has no present plans to do so" per BJ's 2006 Annual Report.

\*Assuming that g is constant for BJ's.

### Expected Price of Stock based on FCF (Exhibit 10)

	Calculation	Value
$g^*_{2007}$		8.21%
WACC*		13.01%
FCF*		\$ 573,485
FCF(1+g)	$573485 * (1+.0821)$	\$ 620,568
WACC - g	$.1301 - .0821$	0.048
Value of Operations Based on FCF	$620568 / .048$	\$ 12,928,502
Value of Debt*	$2736 + 25$	\$ 2,761
# of shares outstanding		65530
Intrinsic Stock Value Per Share	$(34863377 - 2761) / 65530$	\$ 197

Assumptions:

\*see Exhibit 5 for  $g^*_{2007}$  calculation

\*see Exhibit 8 for WACC calculation

\*see Exhibit 2 for FCF calculation

\*Value of Debt for Intrinsic Value calculation also includes \$25k in preferred stock dividends

### Expected Price of Stock based on Market Multiple (Exhibit 11)

	Calculation	Value
EPS (as of 2/3/07)	1.10	1.10
Growth Rate*	8.21%	8.21%
Forecasted Earnings Per Share	$1.10(1+.0821)$	1.19
Price Per Earnings (P/E) Ratio for Costco*		\$ 25.53
Expected Price of BJ's Stock	$\$25.53 * 1.19$	\$ 30.39

Assumptions:

\*Sales Growth Rate was used

\*see Exhibit 3e for Costco P/E ratio

## Cash Conversion Cycle (Exhibit 12)

### Days Inventory Held (DIH)

Inventory/(Sales/365)	BJ's		Costco	
	Calculation	Value	Calculation	Value
Year Ended 2007	850,902/(8,303,496/365)	37.40	4,879,465/(63,087,601/365)	28.23
Year Ended 2006	813,270/(7,748,184/365)	38.31	4,561,232/(58,963,180/365)	28.24
Year Ended 2005	759,742/(7,215,968/365)	38.43	4,014,699/(51,879,070/365)	28.25

Assumptions:

\*Net Sales was used for BJ's

### Days Sales Outstanding (DSO)

Receivables/(Sales/365)	BJ's		Costco	
	Calculation	Value	Calculation	Value
Year Ended 2007	101,292/(8,303,496/365)	4.45	762,017/(63,087,601/365)	4.41
Year Ended 2006	101,435/(7,748,184/365)	4.78	565,373/(58,963,180/365)	3.50
Year Ended 2005	87,292/(7,215,968/365)	4.42	529,150/(51,879,070/365)	3.72

### Days Payables Outstanding (DPO)

Payables/(Cost of Goods Sold/365)	BJ's		Costco	
	Calculation	Value	Calculation	Value
Year Ended 2007	560,406/(7,626,789/365)	26.82	5,124,990/(56,449,702/365)	33.14
Year Ended 2006	556,968/(7,083,642/365)	28.70	4,581,395/(52,745,497/365)	31.70
Year Ended 2005	533,345/(6,612,068/365)	29.44	4,224,676/(46,346,961/365)	33.27

Assumptions:

\*Cost of Goods Sold includes buying and occupancy costs for BJ's

\*Merchandise Costs was used as Cost of Goods Sold for Costco

### Operating Cycle

DSO + DIH	BJ's		Costco	
	Calculation	Value	Calculation	Value
Year Ended 2007	4.45 + 37.40	41.85	4.41 + 28.23	32.64
Year Ended 2006	4.78 + 38.31	43.09	3.50 + 28.24	31.74
Year Ended 2005	4.42 + 38.43	42.84	3.72 + 28.25	31.97

### Cash Conversion Period

Operating Cycle - DPO	BJ's		Costco	
	Calculation	Value	Calculation	Value
Year Ended 2007	41.85 - 26.82	15.03	32.64 - 33.14	-0.50
Year Ended 2006	43.09 - 28.70	14.39	31.74 - 31.70	0.03
Year Ended 2005	42.84 - 29.44	13.40	31.97 - 33.27	-1.30

**BJ'S WHOLESALE CLUB, INC.**  
**CONSOLIDATED STATEMENTS OF INCOME**

	Fiscal Year Ended		
	February 3, 2007	January 28, 2006	January 29, 2005
	(53 weeks)		
	(Dollars in Thousands except Per Share Amounts)		
Net sales	\$ 8,303,496	\$ 7,748,184	\$ 7,215,968
Membership fees and other	176,785	165,919	155,060
Total revenues	<u>8,480,281</u>	<u>7,914,103</u>	<u>7,371,028</u>
Cost of sales, including buying and occupancy costs	7,626,789	7,083,642	6,612,068
Selling, general and administrative expenses	697,585	604,187	554,575
Provision for credit card claims	2,000	4,000	7,000
Preopening expenses	9,524	7,601	13,199
Operating income	<u>144,383</u>	<u>214,673</u>	<u>184,186</u>
Interest income, net	2,638	2,742	803
Gain on contingent lease obligations	3,119	4,494	9,424
Income from continuing operations before income taxes	150,140	221,909	194,413
Provision for income taxes	57,183	86,503	74,799
Income from continuing operations	92,957	135,406	119,614
Loss from discontinued operations, net of income tax benefit of \$14,433, \$4,428 and \$3,370	<u>(20,941)</u>	<u>(6,873)</u>	<u>(5,213)</u>
Net income	<u>\$ 72,016</u>	<u>\$ 128,533</u>	<u>\$ 114,401</u>
Basic earnings per share:			
Income from continuing operations	\$ 1.42	\$ 1.99	\$ 1.72
Loss from discontinued operations	(0.32)	(0.10)	(0.08)
Net income	<u>\$ 1.10</u>	<u>\$ 1.89</u>	<u>\$ 1.64</u>
Diluted earnings per share:			
Income from continuing operations	\$ 1.40	\$ 1.97	\$ 1.71
Loss from discontinued operations	(0.32)	(0.10)	(0.08)
Net income	<u>\$ 1.08</u>	<u>\$ 1.87</u>	<u>\$ 1.63</u>
Number of common shares for earnings per share computations:			
Basic	65,530,278	68,005,849	69,580,978
Diluted	66,387,755	68,755,471	70,131,653

The accompanying notes are an integral part of the financial statements.

**BJ'S WHOLESALE CLUB, INC.**  
**CONSOLIDATED BALANCE SHEETS**

	<u>February 3, 2007</u>	<u>January 28, 2006</u>
(Dollars in Thousands)		
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents .....	\$ 55,877	\$ 162,164
Accounts receivable .....	101,292	101,435
Merchandise inventories .....	850,902	813,270
Current deferred income taxes .....	34,633	24,805
Prepaid expenses .....	26,874	18,195
Total current assets .....	<u>1,069,578</u>	<u>1,119,869</u>
Property at cost:		
Land and buildings .....	639,284	583,950
Leasehold costs and improvements .....	196,206	187,094
Furniture, fixtures and equipment .....	572,522	542,489
	<u>1,408,012</u>	<u>1,313,533</u>
Less: accumulated depreciation and amortization .....	<u>507,864</u>	<u>466,108</u>
	900,148	847,425
Other assets .....	<u>23,085</u>	<u>22,555</u>
Total assets .....	<u>\$1,992,811</u>	<u>\$1,989,849</u>
<b>LIABILITIES</b>		
Current liabilities:		
Current installments of long-term debt .....	\$ 493	\$ 460
Accounts payable .....	560,406	556,968
Accrued expenses and other current liabilities .....	266,864	252,575
Accrued federal and state income taxes .....	34,626	51,568
Closed store lease obligations due within one year .....	4,189	795
Total current liabilities .....	<u>866,578</u>	<u>862,366</u>
Long-term debt, less portion due within one year .....	2,243	2,737
Noncurrent closed store lease obligations .....	14,794	8,159
Other noncurrent liabilities .....	83,377	75,976
Deferred income taxes .....	5,932	24,632
<b>STOCKHOLDERS' EQUITY</b>		
Preferred stock, par value \$.01, authorized 20,000,000 shares, no shares issued .....	—	—
Common stock, par value \$.01, authorized 180,000,000 shares, issued 74,410,190 shares .....	744	744
Additional paid-in capital .....	154,020	132,781
Unearned compensation .....	—	(1,797)
Retained earnings .....	1,158,137	1,105,913
Accumulated other comprehensive loss .....	(723)	—
Treasury stock, at cost, 9,629,542 and 7,017,305 shares .....	<u>(292,291)</u>	<u>(221,662)</u>
Total stockholders' equity .....	<u>1,019,887</u>	<u>1,015,979</u>
Total liabilities and stockholders' equity .....	<u>\$1,992,811</u>	<u>\$1,989,849</u>

The accompanying notes are an integral part of the financial statements.

**BJ'S WHOLESALE CLUB, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	Fiscal Year Ended		
	February 3, 2007	January 28, 2006	January 29, 2005
	(53 weeks)		
	(Dollars in Thousands)		
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Net income	\$ 72,016	\$ 128,533	\$ 114,401
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for credit card claims	2,000	4,000	7,000
Gain on contingent lease obligations	—	(110)	(2,458)
Provision for closing and impairment costs	44,444	527	6,025
Provision for lease accounting corrections	—	—	7,234
Depreciation and amortization of property	105,253	103,807	98,900
Loss on property disposals	1,938	952	502
Other noncash items (net)	1,405	871	896
Share-based compensation expense	18,467	1,314	672
Deferred income taxes	(28,030)	(6,906)	(8,109)
Excess tax benefit from exercise of stock options	(2,754)	—	—
Tax benefit from exercise of stock options	4,570	4,119	4,343
Increase (decrease) in cash due to changes in:			
Accounts receivable	143	(14,143)	(8,370)
Merchandise inventories	(37,632)	(53,528)	(50,380)
Prepaid expenses	(8,679)	1,727	2,718
Other assets	(649)	(45)	194
Accounts payable	(1,611)	30,587	38,018
Changes in book overdrafts	5,049	(6,964)	(11,661)
Accrued expenses	14,424	7,138	20,645
Accrued income taxes	(16,942)	(2,752)	16,393
Closed store lease obligations	(1,138)	(7,441)	(7,100)
Other noncurrent liabilities	615	778	7,366
Net cash provided by operating activities	172,889	192,464	237,229
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Property additions	(190,758)	(123,129)	(133,263)
Proceeds from property disposals	91	53	544
Purchase of marketable securities	(917)	(95,825)	(941,250)
Sale of marketable securities	536	120,625	916,450
Net cash used in investing activities	(191,048)	(98,276)	(157,519)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Excess tax benefit from exercise of stock options	2,754	—	—
Repayment of long-term debt	(461)	(428)	(400)
Cash dividends paid on preferred stock of subsidiary	(25)	(25)	(25)
Proceeds from issuance of common stock	28,050	16,105	12,871
Purchase of treasury stock	(118,446)	(73,234)	(45,318)
Net cash used in financing activities	(88,128)	(57,582)	(32,872)
Net increase (decrease) in cash and cash equivalents	(106,287)	36,606	46,838
Cash and cash equivalents at beginning of year	162,164	125,558	78,720
Cash and cash equivalents at end of period	\$ 55,877	\$ 162,164	\$ 125,558
Supplemental cash flow information:			
Interest paid, net of capitalized interest	\$ 571	\$ 465	\$ 596
Income taxes paid	87,723	91,734	63,145
Noncash financing and investing activities:			
Treasury stock issued for restricted stock, net of forfeitures	\$ 9,679	\$ 734	\$ 4,699
Addition of asset retirement costs	4,233	711	303

The accompanying notes are an integral part of the financial statements.

**BJ'S WHOLESALE CLUB, INC.**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**

	<u>Common Stock</u>	<u>Additional</u>			<u>Accumulated</u>		<u>Treasury Stock</u>		<u>Total</u>
	<u>Shares</u>	<u>Paid-in</u>	<u>Unearned</u>	<u>Retained</u>	<u>Other</u>		<u>Shares</u>	<u>Amount</u>	<u>Stockholders'</u>
	<u>Amount</u>	<u>Capital</u>	<u>Compensation</u>	<u>Earnings</u>	<u>Comprehensive</u>	<u>Loss</u>			<u>Equity</u>
	(In Thousands)								
Balance, January 31,									
2004	74,410	\$744	\$120,718	\$ (185)	\$ 896,683	\$ —	(4,621)	\$(165,739)	\$ 852,221
Net income	—	—	—	—	114,401	—	—	—	114,401
Issuance of common stock	—	—	7,462	(3,116)	(22,503)	—	1,025	35,373	17,216
Dividends	—	—	—	—	(25)	—	—	—	(25)
Purchase of treasury stock	—	—	—	—	—	—	(1,725)	(45,318)	(45,318)
Stock compensation expense	—	—	—	672	—	—	—	—	672
Balance, January 29,									
2005	74,410	\$744	\$128,180	\$(2,629)	\$ 988,556	—	(5,321)	\$(175,684)	\$ 939,167
Net income	—	—	—	—	128,533	—	—	—	128,533
Issuance of common stock	—	—	4,601	(482)	(11,151)	—	839	27,256	20,224
Dividends	—	—	—	—	(25)	—	—	—	(25)
Purchase of treasury stock	—	—	—	—	—	—	(2,535)	(73,234)	(73,234)
Stock compensation expense	—	—	—	1,314	—	—	—	—	1,314
Balance, January 28,									
2006	74,410	\$744	\$132,781	\$(1,797)	\$1,105,913	—	(7,017)	\$(221,662)	\$1,015,979
Net income	—	—	—	—	72,016	—	—	—	72,016
Issuance of common stock	—	—	4,569	—	(19,767)	—	1,553	47,817	32,619
Dividends	—	—	—	—	(25)	—	—	—	(25)
Purchase of treasury stock	—	—	—	—	—	—	(4,166)	(118,446)	(118,446)
Elimination of unearned compensation	—	—	(1,797)	1,797	—	—	—	—	—
Stock compensation expense	—	—	18,467	—	—	—	—	—	18,467
FAS 158 adjustment, net of tax	—	—	—	—	—	(723)	—	—	(723)
Balance, February 3,									
2007	74,410	\$744	\$154,020	\$ —	\$1,158,137	\$(723)	(9,630)	\$(292,291)	\$1,019,887

The accompanying notes are an integral part of the financial statements.

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**COSTCO WHOLESALE CORPORATION**  
**CONSOLIDATED BALANCE SHEETS**  
(amounts in thousands, except par value)

	September 2, 2007	September 3, 2006
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 2,779,733	\$ 1,510,939
Short-term investments	575,787	1,322,181
Receivables, net	762,017	565,373
Merchandise inventories	4,879,465	4,561,232
Deferred income taxes and other current assets	327,151	272,357
Total current assets	<u>9,324,153</u>	<u>8,232,082</u>
<b>PROPERTY AND EQUIPMENT</b>		
Land	3,009,514	2,747,396
Buildings, leasehold and land improvements	7,035,672	6,241,357
Equipment and fixtures	2,747,243	2,405,229
Construction in progress	276,087	248,454
	13,068,516	11,642,436
Less accumulated depreciation and amortization	<u>(3,548,736)</u>	<u>(3,078,141)</u>
Net property and equipment	<u>9,519,780</u>	<u>8,564,295</u>
<b>OTHER ASSETS</b>		
	762,653	698,693
	<u>\$ 19,606,586</u>	<u>\$ 17,495,070</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES</b>		
Short-term borrowings	\$ 53,832	\$ 41,385
Accounts payable	5,124,990	4,581,395
Accrued salaries and benefits	1,226,666	1,080,382
Accrued sales and other taxes	267,920	324,274
Deferred membership fees	692,176	583,946
Current portion of long-term debt	59,905	308,523
Other current liabilities	1,156,264	899,286
Total current liabilities	<u>8,581,753</u>	<u>7,819,191</u>
<b>LONG-TERM DEBT, excluding current portion</b>	<u>2,107,978</u>	<u>215,369</u>
<b>DEFERRED INCOME TAXES AND OTHER LIABILITIES</b>	<u>224,197</u>	<u>253,713</u>
Total liabilities	<u>10,913,928</u>	<u>8,288,273</u>
<b>COMMITMENTS AND CONTINGENCIES</b>		
<b>MINORITY INTEREST</b>		
	69,317	63,358
<b>STOCKHOLDERS' EQUITY</b>		
Preferred stock \$.005 par value; 100,000,000 shares authorized; no shares issued and outstanding	—	—
Common stock \$.005 par value; 900,000,000 shares authorized; 437,013,000 and 462,279,000 shares issued and outstanding	2,185	2,312
Additional paid-in capital	3,118,224	2,822,652
Accumulated other comprehensive income	370,589	277,263
Retained earnings	<u>5,132,343</u>	<u>6,041,212</u>
Total stockholders' equity	<u>8,623,341</u>	<u>9,143,439</u>
	<u>\$ 19,606,586</u>	<u>\$ 17,495,070</u>

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



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**COSTCO WHOLESALE CORPORATION**  
**CONSOLIDATED STATEMENTS OF INCOME**  
(amounts in thousands, except per share data)

	52 weeks ended September 2, 2007	53 weeks ended September 3, 2006	52 weeks ended August 28, 2005
<b>REVENUE</b>			
Net sales	\$ 63,087,601	\$ 58,963,180	\$ 51,879,070
Membership fees	1,312,554	1,188,047	1,073,156
Total revenue	64,400,155	60,151,227	52,952,226
<b>OPERATING EXPENSES</b>			
Merchandise costs	56,449,702	52,745,497	46,346,961
Selling, general and administrative	6,273,096	5,732,141	5,061,339
Preopening expenses	55,163	42,504	53,230
Provision for impaired assets and closing costs, net	13,608	5,453	16,393
Operating income	1,608,586	1,625,632	1,474,303
<b>OTHER INCOME (EXPENSE)</b>			
Interest expense	(64,079)	(12,570)	(34,437)
Interest income and other	165,484	138,355	109,096
<b>INCOME BEFORE INCOME TAXES</b>	<b>1,709,991</b>	<b>1,751,417</b>	<b>1,548,962</b>
Provision for income taxes	627,219	648,202	485,870
<b>NET INCOME</b>	<b>\$ 1,082,772</b>	<b>\$ 1,103,215</b>	<b>\$ 1,063,092</b>
<b>NET INCOME PER COMMON SHARE:</b>			
Basic	\$ 2.42	\$ 2.35	\$ 2.24
Diluted	\$ 2.37	\$ 2.30	\$ 2.18
Shares used in calculation (000's)			
Basic	447,659	469,718	473,945
Diluted	457,641	480,341	492,035
Dividends per share	\$ 0.55	\$ 0.49	\$ 0.43

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

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**COSTCO WHOLESALE CORPORATION**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**  
**AND COMPREHENSIVE INCOME**  
(in thousands)

	Common Stock		Additional Paid-In Capital	Accumulated Other Comprehensive Income	Retained Earnings	Total
	Shares	Amount				
BALANCE AT AUGUST 29, 2004	462,637	\$ 2,313	\$ 1,466,366	\$ 16,144	\$ 6,139,987	\$ 7,624,810
Comprehensive Income:						
Net Income	—	—	—	—	1,063,092	1,063,092
Foreign currency translation adjustment and other	—	—	—	141,895	—	141,895
Comprehensive income						1,204,987
Stock options exercised, including income tax benefits and other	9,138	46	323,545	—	—	323,591
Conversion of convertible notes	9,910	49	277,554	—	—	277,603
Stock repurchase	(9,205)	(46)	(38,848)	—	(374,358)	(413,252)
Stock-based compensation	—	—	67,937	—	—	67,937
Cash dividends	—	—	—	—	(204,567)	(204,567)
BALANCE AT AUGUST 28, 2005	472,480	2,362	2,096,554	158,039	6,624,154	8,881,109
Cumulative effect of adjustments resulting from the adoption of SAB No. 108, net of tax	—	—	147,637	—	(139,481)	8,156
Adjusted balance at August 28, 2005	472,480	2,362	2,244,191	158,039	6,484,673	8,889,265
Comprehensive Income:						
Net Income	—	—	—	—	1,103,215	1,103,215
Foreign currency translation adjustment and other	—	—	—	119,224	—	119,224
Comprehensive income						1,222,439
Stock options exercised, including income tax benefits and other	11,712	59	427,291	—	—	427,350
Conversion of convertible notes	6,505	33	188,902	—	—	188,935
Stock repurchase	(28,418)	(142)	(145,129)	—	(1,316,465)	(1,461,736)
Stock-based compensation	—	—	107,397	—	—	107,397
Cash dividends	—	—	—	—	(230,211)	(230,211)
BALANCE AT SEPTEMBER 3, 2006	462,279	2,312	2,822,652	277,263	6,041,212	9,143,439
Comprehensive Income:						
Net Income	—	—	—	—	1,082,772	1,082,772
Foreign currency translation adjustment and other	—	—	—	93,326	—	93,326
Comprehensive income						1,176,098
Stock options exercised, including income tax benefits, vesting of restricted stock units and other	9,735	48	351,756	—	—	351,804
Conversion of convertible notes	1,389	7	42,323	—	—	42,330
Stock repurchase	(36,390)	(182)	(233,089)	—	(1,745,899)	(1,979,170)
Stock-based compensation	—	—	134,582	—	—	134,582
Cash dividends	—	—	—	—	(245,742)	(245,742)
BALANCE AT SEPTEMBER 2, 2007	437,013	\$ 2,185	\$ 3,118,224	\$ 370,589	\$ 5,132,343	\$ 8,623,341

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

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**COSTCO WHOLESALE CORPORATION**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(amounts in thousands)

	52 Weeks ended September 2, 2007	53 Weeks ended September 3, 2006	52 Weeks ended August 28, 2005
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net income	\$ 1,082,772	\$ 1,103,215	\$ 1,063,092
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	566,385	515,285	481,838
Stock-based compensation	134,582	107,397	67,937
Undistributed equity earnings in joint ventures	(34,080)	(28,180)	(26,459)
Net (gain) / loss on sale of property and equipment and other	(105)	5,867	5,139
Accretion of discount on long-term debt	3,074	4,828	11,855
Excess tax benefit on share-based awards	(25,141)	(31,296)	—
Other non-cash items, net	(5,055)	(5,888)	(11,186)
Change in deferred income taxes	(92,739)	(38,311)	(64,690)
Provision for impaired assets	—	—	3,893
Change in receivables, other current assets, deferred income, accrued and other current liabilities	284,306	414,704	78,118
Increase in merchandise inventories	(272,513)	(499,194)	(315,793)
Increase in accounts payable	434,918	282,797	479,067
Total adjustments	993,632	728,009	709,719
Net cash provided by operating activities	<u>2,076,404</u>	<u>1,831,224</u>	<u>1,772,811</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Additions to property and equipment, net of \$41,519, \$3,934 and \$(3,150) of accrued capital expenditures for fiscal 2007, 2006 and 2005, respectively	(1,385,699)	(1,216,501)	(992,281)
Proceeds from the sale of property and equipment	14,054	15,740	19,432
Investment in unconsolidated joint venture	—	(15,000)	(15,000)
Purchase of minority interests	—	—	(3,961)
Purchases of short-term investments	(1,160,663)	(2,598,355)	(3,741,429)
Maturities of short-term investments	1,417,731	2,424,503	2,401,248
Sales of short-term investments	496,192	263,288	267,640
Change in other assets and other, net	(36,925)	(31,169)	15,988
Net cash used in investing activities	<u>(655,310)</u>	<u>(1,157,494)</u>	<u>(2,048,363)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Change in bank checks outstanding	23,375	33,559	85,829
Proceeds from/(repayments of) short-term borrowings, net	9,961	(12,929)	33,433
Proceeds from issuance of long-term debt, net	1,994,187	18,375	5,660
Repayments of long-term debt	(307,894)	(7,586)	(303,877)
Cash dividend payments	(245,742)	(230,211)	(204,567)
Change in minority interests	5,959	4,744	(130)
Excess tax benefit on share-based awards	25,141	31,296	—
Exercise of stock options	307,988	372,336	278,253
Repurchases of common stock	(1,977,607)	(1,442,811)	(413,252)
Net cash used in financing activities	<u>(164,632)</u>	<u>(1,233,227)</u>	<u>(618,651)</u>
<b>EFFECT OF EXCHANGE RATE CHANGES ON CASH</b>			
Net increase/(decrease) in cash and cash equivalents	1,268,794	(551,646)	(760,550)
<b>CASH AND CASH EQUIVALENTS BEGINNING OF YEAR</b>	<u>1,510,939</u>	<u>2,062,585</u>	<u>2,823,135</u>
<b>CASH AND CASH EQUIVALENTS END OF YEAR</b>	<u>\$ 2,779,733</u>	<u>\$ 1,510,939</u>	<u>\$ 2,062,585</u>
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:</b>			
Cash paid during the year for:			
Interest (net of \$11,423, \$12,681 and \$7,226 interest capitalized for fiscal 2007, 2006 and 2005, respectively)	\$ 9,369	\$ 4,147	\$ 21,374
Income taxes	\$ 786,283	\$ 546,205	\$ 804,957
<b>SUPPLEMENTAL DISCLOSURE OF NON-CASH FINANCING ACTIVITIES:</b>			
Common stock issued upon conversion of 3.5% Zero Coupon Convertible Subordinated Notes	\$ 42,697	\$ 190,871	\$ 280,816

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