# mual Report 2009



YEAR ENDED AUGUST 30, 2009

2009

### THE COMPANY

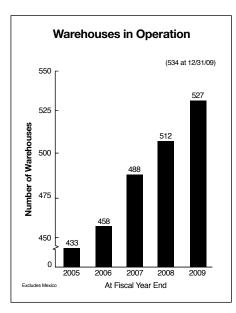
Costco Wholesale Corporation and its subsidiaries ("Costco" or the "Company") began operations in 1983 in Seattle, Washington. In October 1993, Costco merged with The Price Company, which had pioneered the membership warehouse concept, to form Price/Costco, Inc., a Delaware corporation. In January 1997, after the spin-off of most of its non-warehouse assets to Price Enterprises, Inc., the Company changed its name to Costco Companies, Inc. On August 30, 1999, the Company reincorporated from Delaware to Washington and changed its name to Costco Wholesale Corporation, which trades on the NASDAQ under the symbol "COST."

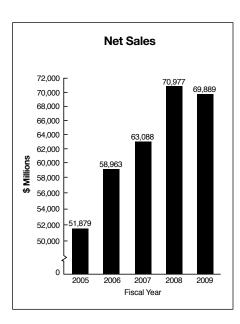
As of December 2009, the Company operated a chain of 566 warehouses in 40 states and Puerto Rico (413 locations), nine Canadian provinces (77 locations), the United Kingdom (21 locations), Korea (seven locations), Taiwan (six locations, through a 55%-owned subsidiary), Japan (nine locations) and Australia (one location), as well as 32 warehouses in Mexico through a 50%-owned joint venture.

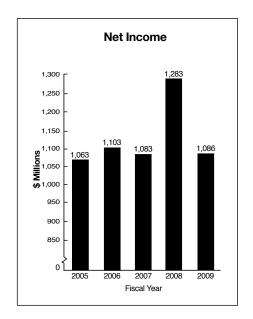
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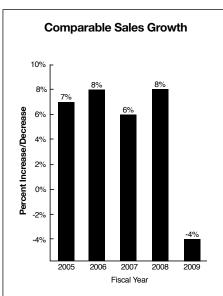
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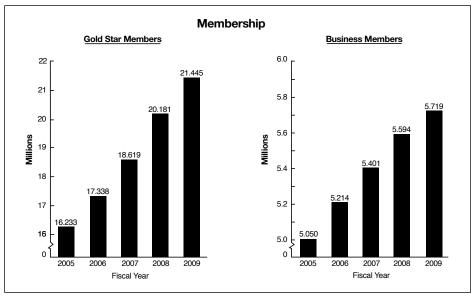
### FINANCIAL HIGHLIGHTS

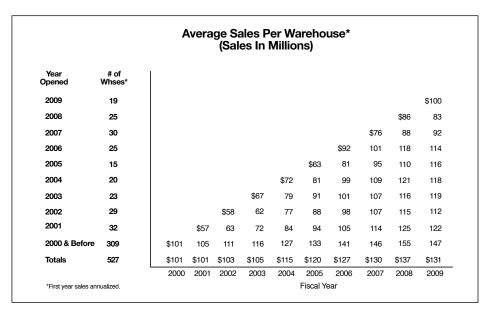


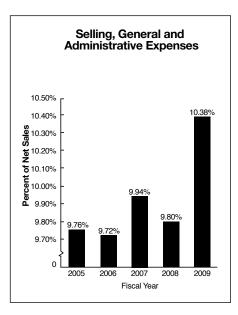












Dear Costco Shareholders,

Since we opened our doors twenty-six years ago, our Company mission has been "to continually provide our members with quality goods and services at the lowest possible prices." This commitment has never been more relevant than today, and nearly 60 million card-carrying members have benefited from this promise every time they shop at any of Costco's 566 warehouses around the globe or at our Ecommerce web sites.

Costco's unique approach to merchandising, operations, and employee engagement has proven successful again and again, ever since we opened our first warehouse in downtown Seattle. Fiscal 2009 provided an opportunity to test our mettle in an unusually challenging economy. We're sure many of you would agree that the current global recession is the worst financial crisis since the Great Depression of the 1930s. While our sales and profits were less than in fiscal 2008, Costco remained solidly profitable in fiscal 2009. During the past fiscal year we opened twenty new warehouses; we increased our membership cardholder base by 2.3 million members, with membership renewals remaining strong at over 87%; and our employees continued to have job security along with one of the best wage and benefits packages in the retail industry.

Fiscal 2009 was the first time in our history when sales did not achieve record highs. Sales were \$69.9 billion, a 1.5% decrease from 2008's results, and for the first time we reported a year of negative comparable sales in warehouses open more than a year: – 4% in 2009. Net earnings again exceeded \$1 billion, but were down from the previous fiscal year by 15%.

We have always maintained that truly great companies should build market share in tough times. During the fiscal year, Costco rose from the fifth-largest U.S. retailer in 2008 to the third-largest in 2009; and we remained the ninth-largest retailer in the world. We also moved from the 29<sup>th</sup> spot in the Fortune 500 to number 24. In addition, in 2009 we were named the 22<sup>nd</sup> most admired company in the world by *Fortune* magazine, and we remained at the top of the University of Michigan's American Consumer Satisfaction Index, a reflection of how well we keep our promise to Costco shoppers.

Our potential for expansion remains as strong as ever. The demand for quality goods and services in Costco's treasure-hunt atmosphere continues to grow, both in the U.S. and around the world, even in times of economic stress. From Texas to Taiwan, people are clamoring for a Costco warehouse in their community. The success of our operations is world-wide; in fact, of our top 20 warehouses for sales in fiscal 2009, half of them were outside the United States.

In fiscal 2009, capital expenditures totaled nearly \$1.3 billion, including the construction and opening of new warehouses and depots, as well as the remodeling and upgrading of many of our existing warehouses. We opened twenty new warehouses in fiscal 2009, including three Business Centers (Commerce and Hawthorne, California and Las Vegas, Nevada), as well as a warehouse we relocated in Bloomfield, Michigan. Almost all of our new U.S. locations were opened in existing markets, and included: Rockwall (Dallas) and Houston (Galleria), Texas; Kapolei, Hawaii; Lakewood, California; St. Charles, Illinois; Brandywine, Maryland; Covington, Washington and Pocatello, Idaho.

Internationally we opened eight new warehouses, which included two new units in Canada – in Peterborough, Ontario, 78 miles from Toronto, and Dartmouth, Nova Scotia, part of the Halifax urban core. In England, we opened a warehouse in the city of Croyden, which is part of greater London. In

Mexico, a second unit was opened in the city of Guadalajara; and we opened three new Asia warehouses in an exciting three-day blitz last July – in Hsinchu, Taiwan, southwest of Taipei; Shin Misato, in greater Tokyo, Japan; and Busan, Korea's second-largest city.

These three countries – Japan, Korea and Taiwan – provide us with great expansion opportunities. When we opened the new warehouses in each country in early July 2009, each warehouse had record-breaking opening day sales for its country – all well over \$700,000 per warehouse. Membership sign-ups through opening day were tremendous at each warehouse – more than 47,000 in Japan – highlighting the potential of the Asia markets for Costco.

Our most thrilling new opening was in Australia last August, where people drove as long as five hours to shop, and lined up to be first through the door. Our Docklands warehouse is in a revitalized area of Melbourne, the country's second-largest city. The Australian market is particularly well-suited to Costco's business model. The population is young and affluent; other retailers' goods are expensive; and the variety of merchandise imported from the U.S. is limited. Australians love the Costco concept and gave us our best-ever opening day sales for a new country – more than \$841,000 U.S. We plan to open a second warehouse in Sydney, in the fall of 2010, and look forward to ongoing expansion.

We also expanded our number of Business Centers this year to seven, opening two in the Los Angeles area – in Hawthorne and City of Commerce – and one in Las Vegas. Costco has always valued its business members; and our Business Centers give us an opportunity to give them both walk-in and delivery options in some of our major markets.

Despite the lower number of openings this year (twenty) compared to prior years – a reflection of economic conditions and the difficulty of completing real estate deals – these new warehouses averaged \$100 million of sales per year on an annualized basis – the highest average for openings in our Company's history. Don't judge the low number of openings as a hesitancy on our part, but rather a reflection of turbulence in the market. We have a significant backlog of projects in the pipeline and are striving to build our annual rate of new Costco openings to between 30-40 per year if conditions permit.

In addition to warehouse openings, we opened three new depots in fiscal 2009 – in Airdrie, Alberta in the Calgary market; Tepeji, Mexico in greater Mexico City; and Ichikawa, Japan in the Tokyo metro area. Our depot system, which now includes 37 state-of-the-art cross-dock facilities, is one of the most efficient forms of merchandise distribution in the world.

As we geared up for the 2009 holiday season, we opened eight more U.S. warehouses: in Paradise Valley, Arizona; Colorado Springs, Colorado; Manhattan, New York; Manchester, Missouri; Strongsville, Ohio; Hayward, California; reopened Redwood City, California; and relocated Warrenton, Oregon. All of these were infills in existing markets.

We currently operate 566 warehouses across the globe: 413 in the U.S. and Puerto Rico, 77 in Canada, 32 in Mexico, 21 in the United Kingdom, nine in Japan, seven in Korea, six in Taiwan and one in Australia. Our goal is still to double our number of units over the next ten years, and we believe this is possible despite the current economic climate.

Our merchandising strategy is a key component to our success, and it is basically the same today as it was at our inception: to bring quality goods and services to our members at the lowest possible prices. Our goal is always to enhance value – that particular combination of quality and price – that makes us

unique in retail; and we attempt to do this with each and every item we carry. At Costco we are dedicated to working both sides of the value equation: increase quality, and whenever possible reduce the price to our members. We accomplish this through successful partnerships with many of the world's leading corporations, and continually focus on developing new relationships with suppliers of high quality merchandise. The current economic climate has helped us establish beginning relationships with some exciting new suppliers that you will find introduced this winter and spring. We also provide value to Costco members by developing our private label Kirkland Signature products, where we have been able to maintain or enhance quality, build special product sizes and pallet configurations, while offering lower prices and becoming even more competitive in the marketplace.

Our ancillary businesses, which include pharmacy, optical, hearing-aid, one-hour photo, food courts and gas stations, continue to offer value to our members. Our dollar-fifty hot dog and soda is legendary, and our pharmacies continue to be acclaimed for low prescription prices and a member-friendly approach, resulting in strong pharmacy sales increases in both prescription and over-the-counter drugs in fiscal 2009. We also opened new central prescription fill centers in Northern and Southern California this past year, and now service more than 175 of our warehouses, reducing the cost of a prescription renewal by almost half. Competition in this area remains keen and requires us to execute creatively and efficiently.

Sales were up in every ancillary department except one-hour photo (due to increased usage of digital cameras) and gasoline (due to significant decreases in gas prices). But while gas sales dollars were down, gallons sold were up, as were profits. Despite a very turbulent market, we sold more than \$5 billion worth of gasoline in fiscal 2009. Adding additional value to our gas stations are our environmentally friendly, state-of-the-art car washes. We operated two in fiscal 2009 – in Seattle, Washington and Poway, California, and this fall we opened six more – one in Scottsdale, Arizona and five in California – in Lancaster, Glendale, Victorville, Oxnard, and South San Francisco. We have plans to add more car washes in the upcoming year.

While we face many challenges, there are a lot of things going right at Costco. We had the best inventory shrink results in our Company's history in fiscal 2009 – below .15% of sales. The change in our member returns policy for certain electronics in mid-year 2007 (concurrent with introducing our concierge program and extended warranty) continues to help bottom line results, with reduced returns and lower cost of disposed products. A similar policy change in Canada in mid-2008 improved their operations, as well. Importantly, we believe we have maintained member satisfaction through this transition.

Another challenge we are dealing with is an increase in selling, general and administrative (SG&A) expenses as a percent of sales. These expenses went up again in 2009, primarily due to rising costs (particularly in health care benefits) and our lower sales base. We are not satisfied with this performance and will continue to emphasize cost controls and expense reduction in all areas of our business.

We spent a relatively small amount (less than \$100 million) to buy back Costco stock in fiscal 2009, compared with the nearly \$900 million expended in fiscal 2008 and the \$1.9 billion we spent to buy back stock in fiscal 2007. Since we began our buy-back program in June 2005, we have repurchased nearly 17% of our outstanding shares. We increased our quarterly cash dividends by  $12\frac{1}{2}$ % in fiscal 2009 – from \$.16 to \$.18, paying out about \$300 million annually in dividends.

As Costco's founders, we have always maintained that we are in business for the long haul, and we believe that our strong emphasis on fiscal responsibility, coupled with operating efficiencies and

creative merchandising, are the fundamentals of Costco's success. Our unique business model and dedication to the ethical treatment of all of our stakeholders – from shareholders to members to suppliers to employees – is an extension of our operating philosophy. That focus carries over into the communities where we operate and to the world at large. Costco and its employees are very involved in volunteerism and philanthropy at the local level. We also are working to expand our relationships with free trade suppliers and those who practice sustainable growth.

Since our inception we have always made conservation and sustainability an emphasis at Costco. Helped by our Corporate Sustainability and Energy Group, we seek to innovate in our pursuit of earth-friendly practices and technology, and we are proud of what we have accomplished – such as skylights in all our warehouses, solar panels on 37 buildings, and an extensive recycling program. Whenever possible, we are developing recyclable packaging and redesigning packaging so that more items fit on a pallet in order to reduce the number of delivery trucks on our roads. Nevertheless, we realize there is still more to be done as we seek to reduce our carbon footprint while meeting our business needs. To learn more about our efforts, please log on to Costco.com and review our Corporate Sustainability Report, published in January 2009.

We know we face challenges. Today's financial environment means that we must work harder than ever before to make a dollar. We must concentrate on cost containment at every level, as well as continually focus our energy on driving sales. Attention to detail is critical in every aspect and segment of our business, ensuring that we deliver on every promise we make to our members and other stakeholders. We believe we have the best and most cohesive management team in the business to help us achieve our goals — men and women who have been with us since the beginning, many of whom have worked together in retail for more than forty years — as well as the best employees in the industry. We are all committed to excellence every day.

We expect the economy will continue to be turbulent throughout 2010. While Costco, like all businesses, will be confronted with difficulties in the coming year, we are confident that the Company will grow despite the lackluster retail climate. We will continue our focus on growing long-term shareholder value by adhering to the policies and practices that made Costco great. We are confident in our entrepreneurial and innovative spirit at every level of our Company.

Our management team and our 147,000 fellow employees worldwide join us in thanking you for your trust and support and for the important role you play in Costco's success. We look forward to seeing many of you at our upcoming Annual Meeting of Shareholders on January 28, 2010, in Bellevue, Washington.

As always, we extend our best wishes for a joyous holiday season and a prosperous and successful New Year.

Warm Regards,

Jeff Brotman

Chairman of the Board

Jim Sinegal
President & CEO

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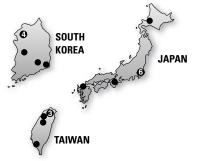
#### LOCATIONS 566

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Fremont

N. Fresno

Fullerton

Gilroy

Goleta

Hawthorne

Hayward

Inglewood

La Habra

La Mesa

Lancaster

La Quinta

Livermore

Norwalk

Novato

Lakewood

Lake Elsinore

Laguna Niguel (2)

Irvine

Hawthorne - Bus. Ctr.

Hayward – Bus. Ctr.

Garden Grove

Fresno

### U.S.A. (413)

#### ALABAMA (3)

Hoover Huntsville Montgomery

### ALASKA (3)

Anchorage N. Anchorage Juneau

#### ARIZONA (17)

Avondale Cave Creek Road Chandler Gilbert S.E. Gilbert Glendale Mesa

### **Paradise Valley**

Phoenix Phoenix - Bus. Ctr. N. Phoenix Prescott Scottsdale Tempe Thomas Road Tucson N.W. Tucson

### **CALIFORNIA (116)**

Alhambra Almaden Antioch Azusa Bakersfield S.W. Bakersfield Burbank Cal Expo Canoga Park Carlsbad Carmel Mountain Chico Chino Hills Chula Vista Citrus Heights

Clovis

Coachella Valley Concord Corona Culver City Cypress Danville El Camino El Centro Eureka Fairfield Folsom Fontana Foster City Fountain Valley

Los Feliz Manteca Merced Mission Valley Modesto Montclair Montebello Moreno Valley City of Industry Mountain View Northridge

Commerce - Bus. Ctr.

Oxnard Poway Rancho Cordova Rancho Cucamonga Rancho del Rey Redding **Redwood City** Richmond Rohnert Park Roseville

**AUSTRALIA** 

San Diego S.E. San Diego San Dimas San Francisco S. San Francisco San Jose N.E. San Jose San Juan Capistrano San Leandro San Luis Obispo San Marcos Sand City Santa Clara Santa Clarita Santa Cruz Santa Maria Santa Rosa Santee

Signal Hill Simi Valley Stockton Sunnyvale Temecula Torrance Tracy Turlock Tustin Tustin II Vacaville Vallejo

Van Nuys Victorville Visalia Vista Westlake Village Woodland Yorba Linda

### COLORADO (12)

Parker

Arvada Aurora Colorado Springs **Colorado Springs West** S.W. Denver **Douglas County** Gypsum

HAWAII (7) Hawaii Kai Honolulu

Sheridan Superior Thornton Westminster

ALASKA

HAWAII

### **CONNECTICUT (5)**

Brookfield Enfield Milford Norwalk Waterbury

### **DELAWARE (1)**

Christiana

### FLORIDA (21)

Altamonte Springs

Boca Raton Brandon Clearwater Davie Estero Fort Myers E. Jacksonville Kendall Lantana Miami N. Miami Beach Miami Lakes Naples E. Örlando S. Orlando Palm Beach Gardens Pembroke Pines Pompano Beach Royal Palm Beach

### Tallahassee GEORGIA (7)

Alpharetta Cumberland Mall Gwinnett Mall of Georgia Morrow Perimeter Town Center

Kailua-Kona Kapolei Kauai Maui

### Waipio **IDAHO** (5)

Boise Coeur d'Alene Nampa

#### **Pocatello** Twin Falls

### ILLINOIS (13) Bedford Park

Bloomingdale Glenview Lake in the Hills Lake Zurich Lincoln Park Mount Prospect Naperville Niles Oak Brook Orland Park

### St. Charles Schaumburg

INDIANA (3) Castleton N.W. Indianapolis Merrillville

### IOWA (1) Des Moines

KANSAS (2) Lenexa

### Overland Park

**KENTUCKY (1)** Louisville

### MARYLAND (8)

Arundel Mills Beltsville **Brandywine** Columbia Frederick Gaithersburg

Glen Burnie White Marsh

MÉXICO

### **MASSACHUSETTS (6)**

∆v∩n Danvers Dedham Everett W. Springfield Waltham

### MICHIGAN (11)

Auburn Hills Bloomfield Commerce Township **Grand Rapids** Green Oak Township Livonia I Livonia II

Madison Heights Roseville Shelby Township

### Wyoming MINNESOTA (5)

Coon Rapids Eden Prairie Maple Grove Maplewood St. Louis Park

#### MISSOURI (5)

Independence Kansas City Manchester S. St. Louis

### St. Peters MONTANA (5)

Billings Bozeman Helena Kalispell Missoula

### NEBRASKA (1)

Omaha

### NEVADA (7)

Carson City Centennial Henderson

### Las Vegas - Bus. Ctr.

Reno Sparks Summerlin

### **NEW HAMPSHIRE (1)**

Nashua

**NEW JERSEY (13) Brick Township** 

Bridgewater Clifton Edison Hackensack F Hanover Hazlet Manahawkin Mount Laurel Ocean Township Union Wayne

### Wharton **NEW MEXICO (3)**

Albuquerque Albuguerque II W. Albuquerque

### NEW YORK (14)

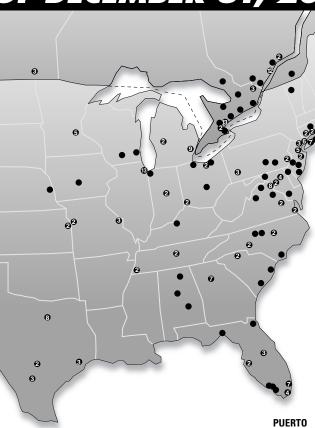
Brooklyn Commack Holbrook Lawrence Manhattan

Salinas

Sacramento

San Bernardino

### DECEMBER 31, 2009



PENNSYLVANIA (7)

Melville

Nanuet

Queens

Westbury

Yonkers

Charlotte

Greensboro

Matthews

Wilmington

Winston-Salem

Deerfield Township

Mayfield Heights

Raleigh

OHIO (7)

Avon

Columbus

Springdale

OREGON (12)

Clackamas

Eugene

Hillsboro

Medford

Portland

Salem

Tigard

Warrenton

Wilsonville

Toledo

Alhany

Aloha

Bend

Strongsville

Durham

Nesconset

New Rochelle

Port Chester

Staten Island

**NORTH CAROLINA (7)** 

Cranberry Harrisburg King of Prussia Lancaster Montgomeryville Robinson West Homestead

**SOUTH CAROLINA (4)** 

Charleston Greenville Myrtle Beach Spartanburg

TENNESSEE (4)

Brentwood N.E. Memphis S.E. Memphis W. Nashville

**TEXAS (17)** 

Arlington Austin S. Austin Duncanville El Paso Fort Worth

Houston

Katy Freeway Lewisville East Plano West Plano

Rockwall

N.W. San Antonio Selma Sonterra Park Southlake Willowbrook

**UTAH (9)** 

W. Bountiful Lehi

Murray S. Ogden Orem St. George Salt Lake City Sandy West Valley

RICO

**VERMONT (1)** 

Colchester

VIRGINIA (15)

Chantilly Chesterfield Fairfax Fredericksburg Harrisonburg W. Henrico Leesburg Manassas

Newington Newport News Norfolk Pentagon City Potomac Mills

Sterlina Winchester

**WASHINGTON (28)** 

Aurora Village Bellingham Burlington Clarkston Covington

Everett Federal Way Fife - Bus. Ctr. Gig Harbor Issaquah Kennewick Kirkland

Lacey

Kamloops

Kelowna Langford Langley Nanaimo Port Coquitlam Prince George Richmond Surrey

Vancouver Willingdon

MANITOBA (3)

Winnipeg E. Winnipeg S. Winnipeg **NEW BRUNSWICK (1)** Moncton

NEWFOUNDLAND

Lynnwood - Bus. Ctr.

Marvsville

Puyallup

Seattle

Seauim

Silverdale

N. Spokane

Spokane

Tacoma

Tukwila

Tumwater

Union Gap

Vancouver

E. Wenatchee

Woodinville

WISCONSIN (2)

PUERTO RICO (4)

CANADA (77)

Bayamón

Caguas

Carolina

ALBERTA (11)

N. Calgary

S. Calgary

Edmonton

N Edmonton

S. Edmonton

Lethbridge

Red Deer

Abbotsford

Burnaby

Grande Prairie

Medicine Hat

Sherwood Park

**BRITISH COLUMBIA (13)** 

N.W. Calgary

E. Bayamón

Grafton

Middleton

**NEWFOUNDLAND (1)** St. John's

**NOVA SCOTIA (2) Dartmouth** 

Halifax

ONTARIO (26) Ajax Ancaster Barrie Brampton Burlington Downsview Etobicoke Gloucester Kanata Kingston Kitchener London North London

Markham E. Markham Mississauga North Mississauga South Nepean

Newmarket

Peterborough Richmond Hill St. Catharines Scarborough Sudbury

Vaughan Windsor

OUÉBEC (18) Anjou Boisbriand

Boucherville

Brossard Candiac Chicoutimi Gatineau Laval Marché Central Montréal Pointe Claire Québec Sainte-Fov Saint-Hubert Saint-Jérôme Sherbrooke Terrehonne Trois-Rivières-Ouest

SASKATCHEWAN (2)

Regina Saskatoon

AUSTRALIA (1) Docklands, Victoria

Iruma Kanazawa Seaside

JAPAN (9)

Amagasaki

Hisayama

Kawasaki Makuhari Sapporo

Shin Misato

Tamasakai

UNITED

**KINGDOM** 

SOUTH KOREA (7)

Busan Daegu Daejeon

llsan Sangbong Yangjae Yangpyung

TAIWAN (6)

Chung Ho Hsinchu Kaohsiung Neihu Shih Chih

Taichung

UNITED KINGDOM (21)

ENGLAND (17)

Birmingham Bristol Chester Chingford Crovdon Derby Gateshead Haydock Leeds Liverpool Manchester

Milton Keynes Oldham Reading

Sheffield Thurrock Watford

SCOTLAND (3)

Aberdeen Edinburgh Glasgow

WALES (1) Cardiff

MÉXICO (32)

(50% Joint Venture)

**AGUASCALIENTES (1)** 

Aguascalientes

**BAJA CALIFORNIA (4)** Ensenada

Mexicali Tiiuana Tijuana II

**BAJA CALIFORNIA SUR (1)** 

Cabo San Lucas

CHIHUAHUA (1)

Juarez

**GUANAJUATO (2)** Celaya

León

**GUERRERO (1)** 

Acapulco

JALISCO (3)

Guadalajara Guadalaiara II

Puerto Vallarta

MÉXICO (4)

Arboledas Interlomas Satélite Toluca

MÉXICO, D.F. (3)

Coapa Mixcoac Polanco

MICHOACÁN (1)

Morelia

MORELOS (1) Cuernavaca

NUEVO LEÓN (2)

Monterrey Monterrey II

PUEBLA (1)

Puebla

QUERÉTARO (1)

Querétaro

**QUINTANA ROO (1)** 

Cancún

SAN LUIS POTOSÍ (1) San Luis Potosí

SONORA (1)

Hermosillo

**VERACRUZ (2)** 

Veracruz Xalapa

YUCATÁN (1)

Mérida

### **BUSINESS OVERVIEW**

### **Forward-Looking Statements**

Certain statements contained in this document constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. They include statements that address activities, events, conditions or developments that we expect or anticipate may occur in the future. Such forward-looking statements involve risks and uncertainties that may cause actual events, results, or performance to differ materially from those indicated by such statements. See Risk Factors, Page 15, for a discussion of risks and uncertainties that may affect our business.

### General

We operate membership warehouses based on the concept that offering our members low prices on a limited selection of nationally branded and selected private-label products in a wide range of merchandise categories will produce high sales volumes and rapid inventory turnover. This rapid inventory 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 maximizes freight volume and handling efficiencies, lowering our receiving costs by eliminating many of the costs associated with 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 have the opportunity to sell and be paid for inventory before we are required to pay many of our merchandise vendors, even though we take advantage of early payment discounts whenever available to us. 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 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 need not have elaborate facilities. By strictly controlling the entrances and exits of our warehouses and using a membership format, we have limited inventory losses (shrinkage) to less than two-tenths of one percent of net sales in the last several fiscal years—well below those of typical discount retail operations.

We generally limit marketing and promotional activities 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, weekly email blasts from costco.com, and handouts) to existing members promoting selected merchandise. These practices result in lower marketing expenses as compared to typical retailers. In connection with new warehouse openings, our marketing teams personally contact businesses in the area that are potential wholesale members. These contacts are supported by direct mailings during the period immediately prior to opening. Potential Gold Star (individual) members are contacted by direct mail or by membership

offerings distributed through employee associations and other entities. After a membership base is established in an area, most new memberships result from word-of-mouth advertising, follow-up messages distributed through employee groups and ongoing direct solicitations to prospective members.

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 closing hours on the weekend. 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 of each item, thereby reducing labor required for handling and stocking.

Our merchandising 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, we carry an average of approximately 3,800 active stock keeping units (SKUs) per warehouse in our core warehouse business, as opposed to 45,000 to 140,000 SKUs or more 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 have a 90-day return policy in the United States, Canada and the United Kingdom and provide, free of charge, technical support services, as well as an extended warranty.

The following table indicates the approximate percentage of net sales accounted for by major category of items:

|  | 2009 | 2008 | 2007 |
|--|------|------|------|
| Sundries (including candy, snack foods, tobacco, alcoholic and nonalcoholic beverages and cleaning and institutional supplies) | 23%  | 22%  | 23%  |
| Hardlines (including major appliances, electronics, health and   |      |      |      |
| beauty aids, hardware, office supplies, garden and patio,  |      |      |      |
| sporting goods, furniture, and automotive supplies)  | 19%  | 19%  | 21%  |
| Food (including dry and institutionally packaged foods)  | 21%  | 20%  | 19%  |
| <b>Softlines</b> (including apparel, domestics, jewelry, housewares,   |      |      |      |
| media, home furnishings, cameras and small appliances)   | 10%  | 10%  | 11%  |
| Fresh Food (including meat, bakery, deli and produce)  | 12%  | 12%  | 12%  |
| Ancillary and Other (including gas stations, pharmacy, food  |      |      |      |
| court, optical, one-hour photo, hearing aid and travel)  | 15%  | 17%  | 14%  |

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:

|                               | 2009 | 2008 | 2007 |
|-------------------------------|------|------|------|
| Food Court and Hot Dog Stands | 521  | 506  | 482  |
| One-Hour Photo Centers        | 518  | 504  | 480  |
| Optical Dispensing Centers    | 509  | 496  | 472  |
| Pharmacies                    | 464  | 451  | 429  |
| Gas Stations                  | 323  | 307  | 279  |
| Hearing-Aid Centers           | 303  | 274  | 237  |
| Print Shops and Copy Centers  | 10   | 7    | 8    |
| Car Washes                    | 2    | 2    | 1    |
| Number of warehouses          | 527  | 512  | 488  |

Costco Mexico, our 50%-owned joint venture, operated 32 warehouses, under our oversight, at August 30, 2009. The Costco Mexico warehouses are not included in the table above as Costco Mexico is accounted for using the equity method of accounting for investments.

Our electronic commerce businesses, costco.com in the U.S. and costco.ca in Canada, provide our members additional products generally not found in our warehouses, in addition to services such as digital photo processing, pharmacy, travel, and membership services.

Our warehouses accept cash, checks, certain debit cards, American Express and 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 payments at the point of sale 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 selected private label merchandise, as long as quality and customer demand are comparable and the value to our members is greater as compared to name brand items.

Certain financial information for our segments and geographic areas is included in Note 12 to the accompanying consolidated financial statements included in this Report.

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). There is no material seasonal impact on our operations, except an increased level of net sales and earnings during the winter holiday season. References to 2009, 2008, and 2007 relate to the 52-week fiscal years ended August 30, 2009, August 31, 2008, and September 2, 2007, respectively.

### Membership Policy

Our membership format is designed to reinforce customer loyalty and provide a continuing source of membership fee revenue, which allows us to offer lower prices. Members can utilize their memberships at any Costco warehouse location in any country. We have two primary types of members: Business and Gold Star (individual). We continue to experience strong member renewal rates, currently at 87%.

Businesses, including individuals with a business license, retail sales license or other evidence of business existence, may become Business members. Business members generally pay an annual membership fee of \$50 for the primary and spouse membership card, with add-on membership cards available for an annual fee of \$40 (including a free spouse card). Many of our business members also shop at Costco for their personal needs. Individual memberships (Gold Star memberships) are available to individuals who do not qualify for a Business membership, for an annual fee of \$50, which includes a spouse card.

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

|                           | 2009   | 2008   | 2007   |
|---------------------------|--------|--------|--------|
| Gold Star                 | 21,500 | 20,200 | 18,600 |
| Business                  | 5,700  | 5,600  | 5,400  |
| Business, Add-on Primary  | 3,400  | 3,400  | 3,500  |
| Total primary cardholders | 30,600 | 29,200 | 27,500 |
| Additional cardholders    | 25,400 | 24,300 | 22,900 |
| Total cardholders         | 56,000 | 53,500 | 50,400 |

These numbers exclude approximately 2,800, 2,800, and 2,700 cardholders of Costco Mexico at the end of 2009, 2008, and 2007, respectively.

Executive membership is available to all members in the U.S., Canada, and United Kingdom for an annual fee of approximately \$100. The program offers additional savings and benefits on various business and consumer services offered by Costco, such as merchant credit-card processing, auto and home insurance, business telephone service, and check printing services. The services are generally provided by third-parties and vary by country and state. In addition, Executive members qualify for a 2% annual reward (which can be redeemed at Costco warehouses), up to a maximum of approximately \$500 per year, on all qualified purchases made at Costco. At the end of 2009, 2008, and 2007, Executive members represented 29%, 26%, and 23%, respectively of our primary membership base. Executive members spend more than other members, and the percentage of our net sales attributable to these members continues to increase. In 2008, Costco Mexico launched an Executive Membership program similar to the program in the U.S. and Canada.

### Labor Our employee count approximated:

|                     | 2009    | 2008    | 2007    |
|---------------------|---------|---------|---------|
| Full-time employees | 79,000  | 75,000  | 70,000  |
| Part-time employees | 63,000  | 62,000  | 57,000  |
| Total employees     | 142,000 | 137,000 | 127,000 |

These numbers exclude approximately 9,000 individuals who were employed by Costco Mexico at the end of 2009, 2008 and 2007. Approximately 13,500 hourly employees in certain of our locations (all former Price Company 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.

### Competition

Our industry is highly competitive, based on factors such as price, merchandise quality and selection, warehouse location and member service. Over 1,200 warehouse club locations exist across the U.S. and Canada, including our 483 North American warehouses, and every major metropolitan area has several club operations. In addition to other membership warehouse operators such as Wal-Mart's Sam's Club and BJ's Wholesale Club, we compete with a wide range of national and regional retailers and wholesalers, including supermarkets, supercenters, general merchandise chains, specialty chains, gasoline stations, as well as electronic commerce businesses, such as Amazon. Wal-Mart, Target and Kohl's are significant general merchandise retail competitors. We also compete with low-cost operators selling a single category or narrow range of merchandise, such as Lowe's, Home Depot, Office Depot, PetSmart, Staples, Trader Joe's, Whole Foods, Best Buy and Barnes & Noble. Our international operations face similar competitors.

### Regulation

Certain state laws require that we apply minimum markups to our selling prices for specific goods, such as tobacco products, alcoholic beverages, and gasoline. While compliance with such laws may cause us to charge higher prices, other retailers are also typically governed by the same restrictions, and we believe that compliance with such laws does not have a material adverse effect on our operations.

Certain states, counties, and municipalities have enacted or proposed laws and regulations that would prevent or restrict the operations or expansion plans of certain large retailers and warehouse clubs, including us, within their jurisdictions. We believe that, if enacted, such laws and regulations could have a material adverse affect on our operations.

### **Intellectual Property**

We believe that our trademarks, trade names, copyrights, proprietary processes, trade secrets, patents, trade dress 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 Costco Wholesale and our premium private label brand, Kirkland Signature<sup>®</sup>. Kirkland Signature products are premium products offered to our members at prices that are generally lower than those for national brand products. Kirkland Signature products allow us to ensure our quality standards are met, while minimizing costs and differentiating our merchandise offerings from other retailers, and we generally earn higher margins on sales of Kirkland products. We expect that our private label items will increase their share of our sales in the future. We rely on trademark and copyright law, trade secret protection, and confidentiality and/or license agreements with our employees and others to protect our proprietary rights. Effective intellectual property protection may not be available in every country in which we operate.

### **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.

### SUSTAINABILITY: ENERGY MANAGEMENT, CONSERVATION AND THE "GREENING" OF COSTCO

Corporate Sustainability and Energy Group Since the beginning of our Company, we have been mindful of our responsibilities as an environmental steward in managing our new construction and the many aspects of our ongoing operations in an energy-efficient and environmentally friendly manner. In 2007, we created the Corporate Sustainability and Energy Group (CSEG) to assess, develop, implement and report on our environmental management efforts. The mission of CSEG is to help Costco's businesses operate in an environmentally and socially responsible and sustainable manner; to reduce Costco's use of resources and generation of waste; and to lead by example. The group has been developing company-wide solutions to manage some aspects of our business most directly related to sustainability, including: data research, tracking and analysis; policy development; designing or assisting with sustainable initiatives related to development, environmental, economic and social concerns; employee education and training; and self-auditing of our systems. In January 2009, the Corporate Sustainability and Energy Group issued the Corporate Sustainability Report, which is available on the Costco.com website. Some of the highlights of this Report and the CSEG's on-going efforts are as follows:

Greenhouse Gas Reduction Program We have implemented a corporate energy policy within an environmental framework, supported by a program for greenhouse gas (GHG) emissions reduction. In 2007 we ceased using HCFC refrigerant, an ozone-depleting substance, in our refrigeration systems, and in 2008 we discontinued its use in our air conditioning systems. During this past year we completed a baseline greenhouse gas emissions inventory that we believe meets standards established by the GHG Protocol Corporate Accounting and Reporting Standard. The inventory accounts for greenhouse gasses emitted into the atmosphere from Company activities (including direct emissions from our own energy-use activities, and indirect issues from our purchased electricity), and provides details on the methods used to make the emissions calculations on an entity-wide basis by facility. We will use this inventory to track emission trends and develop strategies and policies to assess progress. Our goal is to measurably reduce Costco's carbon footprint – the amount of greenhouse gases produced directly and indirectly in our business.

Sustainable Construction and Renewable Energy The organization Leadership in Energy and Environmental Design (LEED) has a certification program that is nationally accepted as a benchmark for green building design and construction. Our metal pre-engineered warehouse design, one of the warehouse design styles we have commonly built over the past several years, is consistent with the requirements of the Silver Level LEED Standard. Our metal building envelopes are all insulated to meet or exceed current energy code requirements, and our main building structure is a pre-engineered system that uses 100% recycled steel material and is designed to minimize the amount of material utilized. The roof materials used on our metal pre-engineered warehouse are 100% recycled standing seam metal panels, designed to maximize efficiency for spanning the structure; and the exterior skin of the building is also 100% recycled metal. In 2008, we opened our first certified Silver Level warehouse in New Jersey, with few changes to our basic building specifications described above. Additionally, over the past three years we have increased our installation of large-scale solar (photovoltaic) power systems from two to a total of thirty-seven locations. By coordinating with state and federal incentive programs, these systems allow us to reduce our carbon footprint and lower the cost of operating our facilities. We continue to evaluate ways to improve energy efficiency.

**Recycling and Waste Stream Management** Waste stream reduction is another major emphasis of our sustainability program. Since the 1980's we have used an increasingly comprehensive recycling program in our operations. Cardboard boxes, for example, used to ship and display merchandise are later used by members to carry home their purchases, eliminating the need for plastic or paper bags. Additionally, the tons of trash that our warehouses generate each week in the form of cardboard, plastic, unusable produce, and other materials, much of which was once discarded, is now being

renewed into usable products, recycled into biofuels or compost, or used as feed stock. We have begun a program in some warehouses where meat scraps and rotisserie chicken grease are recycled by third parties to make animal feed, biodiesel fuel, soaps, etc. In 2009, we installed Goslyn™ grease recovery systems in fifty warehouses, resulting in the recovery of one million pounds of grease from the waste stream for use in the marketplace.

Refurbishing reusable electronic items is another program of recycling in use at Costco. During the past three years, our Electronic Hardware Services (EHS) and Consumer Electronics (CE) Department refurbished for resale nearly 230,000 returned computers, notebooks and PDA's and over 550,000 other returned electronic items (cameras, IPODS, camcorders and televisions). In addition, in 2009 we teamed up with Gazelle, an electronics trade-in company, to offer an on-line trade-in and recycling program. Powered by "Gazelle.com", individuals can trade in old electronic items (laptops, cell phones, LCD monitors, digital cameras, MP3 Players, gaming systems, etc.) and receive a Costco Cash Card for use in any Costco warehouse or at Costco.com. By refurbishing, recycling and keeping renewable materials out of landfills and incinerators, Costco has found new revenue streams while helping protect the environment.

**Energy Efficient Products and Innovative Packaging** We have been an active member of the EPA's Energy Star and Climate Protection Partnerships for the past seven years, and we are also a major retailer of Energy Star qualified compact florescent lamp (CFL) bulbs. We sold more than 35 million CFL bulbs in the U.S. during 2009, with over 124 million sold during the past four years.

Our merchandise packaging is also becoming more environmentally sustainable. In collaboration with our vendors, we actively pursue opportunities to eliminate polyvinyl chloride (PVC) plastic in our packaging and replace it with recycled or recyclable materials. Likewise, innovative packaging design changes, as in the case of square one-gallon milk jugs, have allowed us to increase the amount of product on a pallet, ultimately resulting in fewer delivery trucks on the road.

**Commuting** We continue to encourage our employees to carpool or vanpool whenever possible - to reduce energy consumption, as well as reduce emissions going into the atmosphere. The Commute Trip Reduction (CTR) program we began fifteen years ago at our corporate office with eighteen vans now has sixty vans (vans, fuel, maintenance and insurance provided by five transit agencies); and this past year we began six vanpools in our California regional offices. We offer employees subsidies to vanpool, and we subsidize employees who purchase monthly bus passes. In addition, we encourage employees to ride bikes to work when practical. All of these programs and activities help reduce our carbon footprint.

### **RISK FACTORS**

The risks described below could materially and adversely affect our business, financial condition, and/ or results of operations. These risks could cause our actual results to differ materially from our historical experience and from results predicted by our forward-looking statements. Those statements may relate to such matters as sales growth, increases in comparable store sales, impact of cannibalization, price changes, earnings performance, earnings per share, stock-based compensation expense, warehouse openings and closures, the effect of adopting certain accounting standards, future financial reporting, financing, margins, return on invested capital, strategic direction, expense control, membership renewal rates, shopping frequency, litigation impact and the demand for our products and services. You should read these risk factors in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 7 of this Report and our consolidated financial statements and related notes in Item 8 of this Report. There may be other factors that we cannot anticipate or that are not described in this report, generally because we do not presently perceive them to be material, that could cause results to differ materially from our expectations. Forward-looking statements speak only as of the date they are made, and we do not undertake to update these forward-looking statements. You are advised to review any further disclosures we make on related subjects in our periodic filings with the SEC.

### We face strong competition from other retailers and warehouse club operators, which could negatively affect our financial performance.

The retail business is highly competitive. We compete for members, employees, warehouse sites, products and services and in other important respects with many other local, regional and national retailers, both in the United States and in foreign countries. We compete with other warehouse club operators, discount retailers, supermarkets, supercenter stores, retail and wholesale grocers, department, drug, variety and specialty stores and general merchandise wholesalers and distributors, as well as internet-based retailers, wholesalers and catalog businesses. Such retailers and warehouse club operators compete in a variety of ways, including merchandise pricing, selection and availability, services, location, convenience, store hours, and price. Our inability to respond effectively to competitive pressures and changes in the retail markets could negatively affect our financial performance. Some competitors may have greater financial resources, better access to merchandise, and/or greater market penetration than we do.

### General economic factors, domestically and internationally, may adversely affect our financial performance.

Higher interest rates, energy costs, inflation, levels of unemployment, healthcare costs, consumer debt levels, unsettled financial markets, weaknesses in housing and real estate markets, reduced consumer confidence, changes related to government fiscal and tax policies 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 and periodic delays in delivery. Rapid and significant changes in commodity prices may affect our sales and profit margins. These factors can also increase our merchandise costs and/or selling, general and administrative expenses, and otherwise adversely affect our operations and results. General economic conditions can also be affected by the outbreak of war, acts of terrorism, or other significant national or international events.

### Our growth strategy includes expanding our business, both in existing markets and in new markets.

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. Failure to manage these and other similar factors effectively will affect our ability to timely build or lease new warehouses, which may have a material adverse affect 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 nearby existing warehouses and may 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; as a result, our future profitability may be delayed or otherwise materially adversely affected.

### We are highly dependent on the financial performance of our United States and Canada operations.

Our financial and operational performance is highly dependent on our United States and Canada operations, which comprised 93% of consolidated net sales in 2009 and 2008, and 92% of operating income in 2009 and 2008. Within the United States, we are highly dependent on our California operations, which comprised 27% of consolidated net sales in 2009 and 2008. Our California market in general, has a larger percentage of higher volume warehouses as compared to our other markets. As a result, the operating income from our California operations is generally higher as a percentage of total operating income than other regions. Any substantial slowing or sustained decline in these operations could materially adversely affect our business and financial results. Declines in financial performance of our United States operations, particularly in California, and our Canada 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; and failing consistently to provide high quality products and innovative new products to retain our existing member base and attract new members.

### We depend on vendors to supply us with quality merchandise at the right prices in a timely manner.

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.

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.

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 hurt our business.

In addition, the United States' foreign trade policies, tariffs and other impositions on imported goods, security and safety regulations, trade sanctions imposed on certain countries, the limitation on the importation of certain types of goods or of goods containing certain materials from other countries and other factors relating to foreign trade are beyond our control.

### We depend on our depot operations to effectively and efficiently supply product to our warehouses.

We depend on the orderly operation of the 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 or other catastrophic events, labor disagreements 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 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. The success of our business 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 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 and operating income.

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

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.

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

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, sales returns reserves, impairment of long-lived assets and warehouse closing costs, inventories, self-insurance, income taxes, unclaimed property laws and litigation, 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.

### **Changes in Tax Rates**

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, or any change in the pronouncements relating to accounting for income taxes may have a material adverse affect on our financial condition, results of operation, or cash flows.

### Failure of our internal control over financial reporting could limit our ability to report our financial results accurately and timely.

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting for external purposes in accordance with U.S. generally accepted accounting principles. Internal control over financial reporting includes: maintaining records that in reasonable detail accurately and fairly reflect our transactions; providing reasonable assurance that transactions are recorded as necessary for preparation of the financial statements; providing reasonable assurance that our receipts and expenditures of our assets are made in accordance with management authorization; and providing reasonable assurance that unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements would be prevented or detected on a timely basis. Because of its inherent limitations, internal control over financial reporting is not intended to and cannot provide absolute assurance that a misstatement of our financial statements would be prevented or detected. Any failure to maintain an effective system of internal control over financial reporting could limit our ability to report our financial results accurately and timely or to detect and prevent fraud.

# 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 financial performance.

Our international operations could form a larger portion of our business in future years. Future operating results internationally could be negatively affected by a variety of factors, many 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 both of the United States and of other countries, laws and regulations of foreign governments and the United States (such as the Foreign Corrupt Practices Act), agencies and similar organizations, and risks associated with having major facilities located in countries which have been historically less stable than the United States. 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 may have an impact on our future costs or on future cash flows from our international operations.

### Market expectations for our financial performance is high.

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, 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 share repurchase policies.

# We rely extensively on computer systems to process transactions, summarize results and manage our business. Disruptions in both our primary and back-up systems could harm our business.

Although we have independent, redundant, and 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 investment to fix or replace them, and we may suffer interruptions in our operations in the interim. Any material interruption in our computer systems may have a material adverse effect on our business or results of operations. The costs, 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 provide them in a delayed or more costly manner.

### Natural disasters or other catastrophic events could unfavorably affect our financial performance.

Natural disasters, such as hurricanes or earthquakes, particularly in California or in Washington state, where our centralized operating systems and administrative personnel are located, could unfavorably 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 and overseas suppliers, the temporary disruption in the transport of goods from overseas, delays in the delivery of goods to our depots or warehouses within a country in which

we operate and the temporary reduction in the availability of products in our warehouses. Public health issues, such as a potential H1N1 flu pandemic (Swine flu), whether occurring in the United States or abroad, could disrupt our operations, disrupt the operations of suppliers or customers, or have an adverse impact on consumer spending and confidence levels. 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. These events could also reduce demand for our products or make it difficult or impossible to receive products from suppliers.

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 and hazardous and non-hazardous wastes, and other environmental matters.

Any failure to comply with these laws could result in 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 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 may unfavorably affect our operations or increase our costs.

We are involved in a number of legal proceedings and audits, including grand jury investigations, other government investigations, consumer, employment, tort and other litigation (see discussion of Legal Proceedings in Note 11 to the consolidated financial statements on page 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 and other contingencies could require us to take or refrain from taking actions which could unfavorably affect our operations or could require us to pay substantial amounts of money. Additionally, defending against these lawsuits and proceedings may involve significant expense and diversion of management's attention and resources. 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 subject to the risk of product liability claims.

If our merchandise offerings, including food and prepared food products for human consumption, drugs and childrens' products, do not meet applicable safely 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 injury to our members. Such injuries may 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. All of our vendors must 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 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. 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.

### Our success depends, in part on the continued contributions of management and on our ability to attract, train and retain highly qualified employees.

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. Other than an annual agreement with our President and CEO, Mr. Sinegal, 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. Our ability to control labor costs is subject to numerous external factors, including 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 the Company's business, results of operations and financial condition. The Company does not maintain key man insurance.

# If we do not maintain the privacy and security of member-related 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. In addition, our online operations at www.costco.com and www.costco.ca depend upon the secure transmission of confidential information over public networks, including information permitting cashless payments. A compromise of our security systems or those of other business partners 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 sales operations.

Additionally, the use of individually identifiable data by our business and our business associates is regulated at the international, federal and state levels. 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.

### **PROPERTIES**

### **Warehouse Properties**

At August 30, 2009, we operated 527 membership warehouses:

### **NUMBER OF WAREHOUSES**

|                               | Own Land<br>and Building | Lease Land<br>and/or<br>Building(1) | Total |
|-------------------------------|--------------------------|-------------------------------------|-------|
| United States and Puerto Rico | 323                      | 83                                  | 406   |
| Canada                        | 68                       | 9                                   | 77    |
| United Kingdom                | 19                       | 2                                   | 21    |
| Japan                         | 1                        | 8                                   | 9     |
| Korea                         | 3                        | 4                                   | 7     |
| Taiwan                        | _                        | 6                                   | 6     |
| Australia                     | 1                        |                                     | 1     |
| Total                         | 415                      | 112                                 | 527   |

<sup>(1) 75</sup> of the 112 leases are land-leases only, where Costco owns the building.

The following schedule shows warehouse openings (net of closings) by region for the past five fiscal years and expected warehouse openings (net of closings) through December 31, 2009:

| Openings by Fiscal Year          | United States | Canada | Other<br>International | Total | Total Warehouses in Operation |
|----------------------------------|---------------|--------|------------------------|-------|-------------------------------|
| 2005 and prior                   | 338           | 65     | 30                     | 433   | 433                           |
| 2006                             | 20            | 3      | 2                      | 25    | 458                           |
| 2007                             | 25            | 3      | 2                      | 30    | 488                           |
| 2008                             | 15            | 4      | 5                      | 24    | 512                           |
| 2009                             | 8             | 2      | 5                      | 15    | 527                           |
| 2010 (expected through 12/31/09) | 7             |        |                        | 7     | 534                           |
| Total                            | 413           | 77     | 44                     | 534   |                               |

The 32 warehouses operated by Costco Mexico, under our oversight, at the end of 2009 are not included in the above tables. We opened one warehouse in Mexico in 2009.

At the end of 2009, our warehouses contained approximately 75.2 million square feet of operating floor space: 58.6 million in the United States, 10.5 million in Canada and 6.1 million in other international locations, excluding Mexico.

### **Administrative and Merchandise Distribution Properties**

Our executive offices are located in Issaquah, Washington and occupy approximately 445,000 square feet. We operated eight regional offices in the United States, two regional offices in Canada and five regional offices internationally at the end of 2009, containing approximately 334,000 square feet. Additionally, we operate regional cross-docking facilities (depots) for the consolidation and distribution of most shipments to the warehouses, and various processing, packaging, and other facilities to support ancillary and other businesses. At the end of 2009, we operated eleven depots in the United States, four in Canada and three internationally, excluding Mexico, consisting of approximately 7.3 million square feet.

### MARKET FOR COSTCO COMMON STOCK

### **Market Information and Dividend Policy**

Our common stock is traded on the National Market tier of the NASDAQ Global Select Market ("NASDAQ") under the symbol "COST." We are authorized to issue up to 900,000,000 shares of common stock, par value \$.005, and up to 100,000,000 shares of preferred stock, par value \$.005. Total shares of common stock outstanding at October 2, 2009 were 435,989,212, and we had 8,459 stockholders of record. There are no preferred shares issued and outstanding

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 during the periods indicated.

|                | Price Range |         | Cash<br>Dividends |  |
|----------------|-------------|---------|-------------------|--|
|                | High        | Low     | Declared          |  |
| 2009:          |             |         |                   |  |
| Fourth Quarter | \$51.77     | \$44.54 | \$0.180           |  |
| Third Quarter  | 48.91       | 38.44   | 0.180             |  |
| Second Quarter | 55.58       | 42.76   | 0.160             |  |
| First Quarter  | 70.37       | 44.99   | 0.160             |  |
| 2008:          |             |         |                   |  |
| Fourth Quarter | 74.66       | 60.35   | 0.160             |  |
| Third Quarter  | 72.65       | 60.04   | 0.160             |  |
| Second Quarter | 71.83       | 63.24   | 0.145             |  |
| First Quarter  | 69.24       | 57.00   | 0.145             |  |

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

### Stock Repurchase Program (dollars in millions)

Our stock repurchase program is conducted under authorizations made by our Board of Directors. Since inception of the program in October 2004, through fiscal 2009, the Board has authorized a total of \$6,800 for stock repurchases, including \$300 and \$1,000 authorized in September 2007 and November 2007, which expire in August 2010 and November 2010, respectively, and \$1,000 authorized in July 2008, which expires in July 2011.

Since inception of the program, we have repurchased 88.7 million shares of our common stock for a total cash investment of \$4,798 (\$54.08 per share) through 2009 fiscal year end. The maximum remaining dollar value of shares that may be purchased under the stock repurchase program is \$2,002.

There was no common stock repurchase program activity for the fourth quarter of 2009.

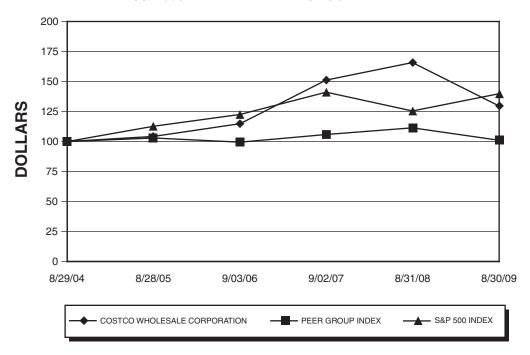
### **Equity Compensation Plans**

Information related to our equity compensation plans is incorporated herein by reference to the Proxy Statement. The Proxy Statement will be filed with the SEC within 120 days of the end of our fiscal year.

### Performance Graph

The following graph compares the cumulative total shareholder return (stock price appreciation plus dividends) on our common stock for the last five years with the cumulative total return of the S&P 500 Index and the following group of peer companies (based on weighted market capitalization) selected by the Company: BJ's Wholesale Club, Inc.; The Home Depot, Inc.; Lowe's Companies; Best Buy Co., Inc.; Office Depot, Inc.; Staples Inc.; Target Corporation; Kroger Company; and Wal-Mart Stores, Inc. The information provided is from August 29, 2004 through August 30, 2009.

### COMPARISON OF 5-YEAR CUMULATIVE TOTAL RETURN AMONG COSTCO WHOLESALE CORPORATION, S&P 500 INDEX AND PEER GROUP INDEX



The graph assumes the investment of \$100 in Costco common stock, the S&P 500 Index and the Peer Group Index on August 29, 2004 and reinvestment of all dividends.

### **Annual Meeting of Shareholders**

Our annual meeting of shareholders is scheduled for 4:00 p.m. on January 28, 2010, at the Meydenbauer Center in Bellevue, Washington. Matters to be voted on are included in our proxy statement filed with the SEC and distributed prior to the meeting.

### FIVE YEAR OPERATING AND FINANCIAL HIGHLIGHTS

The following table sets forth certain information concerning our consolidated financial condition, operating results, and key operating metrics for the dates and periods indicated. This information should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations, and our Consolidated Financial Statements.

SELECTED FINANCIAL DATA (dollars in millions, except per share and warehouse data)

| As of and for the year ended(1)  | Aug. 30, 2009<br>(52 weeks) | Aug. 31, 2008<br>(52 weeks) | Sept. 2, 2007<br>(52 weeks) | Sept. 3, 2006<br>(53 weeks) | Aug. 28, 2005<br>(52 weeks) |
|--|-----------------------------|-----------------------------|-----------------------------|-----------------------------|-----------------------------|
| RESULTS OF OPERATIONS  |                             |                             |                             |                             |                             |
| Net sales Merchandise costs  | \$69,889<br>62,335          | \$70,977<br>63,503          | \$63,088<br>56,450          | \$58,963<br>52,745          | \$51,879<br>46,347          |
| Gross Margin   | 7,554                       | 7,474                       | 6,638                       | 6,218                       | 5,532                       |
| Membership fees  | 1,533                       | 1,506                       | 1,313                       | 1,188                       | 1,073                       |
| Operating income   | 1,777                       | 1,969                       | 1,609                       | 1,626                       | 1,474                       |
| Net income Net income per diluted common                               | 1,086                       | 1,283                       | 1,083                       | 1,103                       | 1,063                       |
| share  | 2.47                        | 2.89                        | 2.37                        | 2.30                        | 2.18                        |
| Dividends per share  | \$ 0.68                     | \$ 0.61                     | \$ 0.55                     | \$ 0.49                     | \$ 0.43                     |
| United States  | (2)%                        | 6%                          | 5%                          | 7%                          | 6%                          |
| International  | (8)%                        | 15%                         | 9%                          | 11%                         | 11%                         |
| Total  | (4)%                        | 8%                          | 6%                          | 8%                          |                             |
| Increase in International comparable warehouse sales in local currency | 7%                          | 6%                          | 5%                          | 7%                          | 4%                          |
| equipment  | \$10,900                    | \$10,355                    | \$ 9,520                    | \$ 8,564                    | \$ 7,790                    |
| Total assets   | 21,979                      | 20,682                      | 19,607                      | 17,495                      | 16,665                      |
| Short-term borrowings Current portion of long-term                     | 16                          | 134                         | 54                          | 41                          | 54                          |
| debt   | 81                          | 6                           | 60                          | 309                         | 3                           |
| current portion  | 2,206                       | 2,206                       | 2,108                       | 215                         | 711                         |
| Stockholders' equity   | \$10,018                    | \$ 9,192                    | \$ 8,623                    | \$ 9,144                    | \$ 8,881                    |
| WAREHOUSE INFORMATION Warehouses in Operation(3)                       |                             |                             |                             |                             |                             |
| Beginning of year  | 512                         | 488                         | 458                         | 433                         | 417                         |
| Opened(4)  | 19                          | 34                          | 30                          | 28                          | 21                          |
| Closed(4)  | (4)                         | (10)                        |                             | (3)                         | (5)                         |
| End of Year  | 527                         | 512                         | 488                         | <u>458</u>                  | 433                         |
|  |                             |                             |                             |                             |                             |

<sup>(1)</sup> Certain reclassifications have been made to prior years to conform to the presentation adopted in the current year.

<sup>(2)</sup> Includes net sales at warehouses open greater than one year, including relocated locations.

<sup>(3)</sup> Excludes warehouses operated in Mexico through a 50% owned joint venture.

<sup>(4)</sup> Includes relocations and the closure in July 2009 of two Costco Home locations.

### MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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

### Overview

Our fiscal year ends on the Sunday closest to August 31. References to 2009, 2008, and 2007 relate to the 52-week years ended August 30, 2009, August 31, 2008, and September 2, 2007 respectively.

Key items for 2009 included:

- Net sales decreased 1.5% from the prior year to \$69,889, attributable to a 4% decrease in comparable sales (sales in warehouses open for at least one year, including relocated warehouses), partially offset by the opening of 15 new warehouses (19 opened, two closed due to relocation, and the closure of our two Costco Home locations) in 2009. Net sales were significantly impacted by the year-over-year decrease in the price of gasoline and by certain foreign exchange rates;
- Membership fees increased 1.8%, to \$1,533, primarily due to new membership sign-ups at warehouses opened in 2009, the continued benefit of membership sign-ups at warehouses opened in 2008, and increased penetration of our higher-fee Executive Membership program. Membership fees were negatively impacted by a \$27 charge related to a proposed litigation settlement concerning our membership renewal policy;
- Gross margin (net sales less merchandise costs) as a percentage of net sales increased 28 basis points over the prior year,
- Selling, general and administrative (SG&A) expenses as a percentage of net sales increased 58 basis points over the prior year;
- Net income decreased 15% to \$1,086, or \$2.47 per diluted share, in 2009 compared to \$1,283, or \$2.89 per diluted share, in 2008;
- The Board of Directors approved an increase in the quarterly cash dividend from \$0.16 to \$0.18 per share; and
- We repurchased 895,000 shares of our common stock, at an average cost of \$63.84 per share, totaling approximately \$57.

As previously reported, 2007 was impacted by the following unusual items, the effects of which are reflected in the table below:

- Sales returns reserve: We revised our estimate of our sales returns reserve to include a longer timeframe for returns, as well as a lower realization rate on certain returned items.
- Employee tax consequences on stock options: We made payments to employees in connection with changes in exercise prices designed to avoid adverse tax consequences for employees and recorded a charge for the estimated amount to remedy adverse tax consequences related to stock options held and previously exercised by employees outside the United States.
- Excise tax refund: We received a refund related to 2002 through 2006, as a result of a settlement with the U.S. Internal Revenue Service relating to excise taxes previously paid.
- Deferred membership: We analyzed the timing of recognition of membership fees, resulting in a reduction to membership fee revenue and a corresponding increase to deferred membership fees on our consolidated balance sheet.

We believe disclosing the effects of these items helps provide a meaningful comparison of our current year results to prior years. The impact of each of these items noted above is presented below:

|                            | 2007                 |  |                        |                   |                 |
|----------------------------|----------------------|--|------------------------|-------------------|-----------------|
|                            | Sales return reserve | Employee tax consequences on stock options | Deferred<br>membership | Excise tax refund | Total           |
| Net sales                  | \$(452)              | \$ —                                       | \$ —                   | \$—               | \$(452)         |
| Membership fees            |                      |  | (56)                   |                   | (56)            |
| Total revenue              | (452)                | _  | (56)                   | _                 | (508)           |
| Merchandise costs          | 358                  |  |                        | 9                 | 367             |
| Gross margin(1)            | (94)                 | _  |                        | 9                 | (85)            |
| SG&A                       |                      | (47)                                       |                        |                   | (47)            |
| Operating income           | (94)                 | (47)                                       | (56)                   | 9                 | (188)           |
| Interest expense           |                      | _  |                        | _                 | _               |
| Interest income and other  | (1)                  |  |                        | 1                 |                 |
| Income before income taxes | (95)                 | (47)                                       | (56)                   | 10                | (188)           |
| Provision for income taxes | 35                   | 17   | 21                     | (4)               | 69              |
| Net Income                 | \$ (60)              | <u>\$(30)</u>                              | <u>\$(35)</u>          | \$ 6              | <u>\$(119</u> ) |

<sup>(1)</sup> Net sales less merchandise costs.

### **Results of Operations**

### Net Sales

|  | 2009     | 2008     | 2007     |
|--|----------|----------|----------|
| Net sales  | \$69,889 | \$70,977 | \$63,088 |
| reserve  |          |          | 452      |
| Net sales, as adjusted   | \$69,889 | \$70,977 | \$63,540 |
| Net sales (decrease) increase  | (1.5)%   | 12.5%    | 7.0%     |
| Net sales (decrease) increase, as adjusted Increase (decrease) in comparable warehouse | (1.5)%   | 11.7%    | 7.8%     |
| sales  | (4)%     | 8%       | 6%       |
| Warehouse openings, net  | 15       | 24       | 30       |

2009 vs. 2008

### Net Sales

Our 2009 sales results, particularly in hardlines and softlines, were negatively impacted by general economic conditions, and we believe that those conditions may continue to have a significant adverse impact on spending by our members. We believe, however, that due to the nature of our business model, we are better positioned than many retailers to compete in such an environment.

Net sales decreased 1.5% during 2009 compared to 2008. The \$1,088 decrease was comprised of a \$2,590 decrease in comparable sales, partially offset by an increase of \$1,502 primarily from sales at new warehouses opened during 2009 and 2008. Our sales were also impacted by a lower number of warehouse openings year-over-year.

Foreign currencies, particularly in Canada, the United Kingdom, and Korea, weakened against the U.S. dollar, which negatively impacted net sales during 2009 by approximately \$2,421 (341 basis points). Net sales were also negatively impacted by gasoline price deflation during 2009 by approximately \$2,164 (305 basis points), which resulted from a 30% decline in the average sales price per gallon.

### Comparable Sales

Comparable sales decreased 4% in 2009. Weakening foreign currencies negatively impacted comparable sales by approximately \$2,339 (333 basis points) in 2009. Gasoline price deflation negatively impacted comparable sales results by approximately \$2,113 (298 basis points) during 2009. Comparable sales were negatively impacted by a decline in the average amount spent (after adjustment for gasoline price deflation and measured in local currencies), partially offset by an increase in shopping frequency. Reported comparable sales growth includes the negative impact of cannibalization (established warehouses losing sales to our newly opened locations). We believe the decline is a function of adverse economic conditions generally rather that a fundamental change in our members' relationship to the company.

### 2008 vs. 2007

Net sales increased 12.5% to \$70,977 in 2008, from \$63,088 in 2007. Excluding the impact of the change in the estimated sales returns reserve in 2007, net sales, as adjusted, increased \$7,437, or 11.7% in 2008 as compared to the previous year. The \$7,437 increase in adjusted net sales is comprised of \$5,153 from the increase in comparable warehouse sales and \$2,284 primarily from sales at new warehouses opened during 2008 and 2007. In the third quarter of 2007, we introduced a 90-day return policy in the United States on certain electronic items.

Significantly stronger foreign currencies, particularly in Canada, positively impacted adjusted net sales by approximately \$1,134, or 180 basis points. Gasoline sales also contributed to the \$7,437 adjusted net sales growth by approximately \$2,236, with approximately \$1,489 related to the increase in gasoline sales prices. Additionally, we experienced price increases in certain foods and fresh foods items that positively impacted net sales, which were partially offset by price decreases in certain items within our hardlines category.

Most of the comparable sales growth was derived from increased amounts spent by members, with a smaller contribution from increases in shopping frequency. Gasoline sales positively impacted comparable warehouse sales growth by approximately \$1,938. Comparable warehouse sales growth excluding gasoline would have been lower by approximately 267 basis points. Significantly stronger foreign currencies, particularly in Canada, positively impacted comparable sales by approximately \$1,070, or 170 basis points. Reported comparable sales growth includes the negative impact of cannibalization (established warehouses losing sales to our newly opened locations).

### Membership Fees

|  | 2009             | 2008              | 2007              |
|--|------------------|-------------------|-------------------|
| Membership fees  | \$ 1,533<br>     | \$ 1,506<br>—     | \$ 1,313<br>56    |
| Membership fees, as adjusted   | \$ 1,533<br>1.8% | \$ 1,506<br>14.7% | \$ 1,369<br>10.5% |
| Membership fees increase, as adjusted  | 1.8%<br>2.19%    | 10.0%             | 15.2%             |
| Membership fees as a percent of net sales Adjusted membership fees, as a percent of adjusted | 2.19%            | 2.12%             | 2.08%             |
| net sales  | 2.19%            | 2.12%             | 2.16%             |
| Total cardholders  | 56,000           | 53,500            | 50,400            |

Membership fees increased 1.8% in 2009 compared to 2008, primarily due to membership sign-ups at the 15 new warehouses opened in 2009 (19 opened, two closed due to relocations, and two closed Costco Home locations), the continued benefit of membership sign-ups at warehouses opened in 2008, and increased penetration of our higher-fee Executive Membership program. This increase was negatively impacted by a charge of \$27 related to a proposed litigation settlement concerning our membership renewal policy and the weakening of foreign currencies against the U.S. dollar, particularly in Canada, the United Kingdom, and Korea, which negatively impacted membership fees during 2009 by approximately \$50. Membership fees were also impacted by a lower number of warehouse openings year-over-year. Our member renewal rate, currently at 87% is consistent with recent years.

As previously disclosed, effective with renewals occurring on and after March 1, 2009, we changed an element of our membership renewal policy. Memberships renewed within two months after expiration of the current membership year are extended for twelve months from the expiration date. (Under the previous policy, renewals within six months of the expiration date were extended for twelve months from the expiration date.) Memberships renewed more than two months after such expiration date are extended for twelve months from the renewal date. Although this change will have the effect of deferring recognition of certain membership fees paid by late-renewing members, the effect is not expected to be material.

### 2008 vs. 2007

Membership fees increased 14.7% to \$1,506, or 2.12% of net sales in 2008, from \$1,313, or 2.08% of net sales in 2007. Excluding the adjustment to deferred membership fees in 2007, adjusted membership fees increased 10.0% from 2007. The increase was primarily due to: new membership sign-ups at the 24 new warehouses opened (34 opened and 10 closed due to relocations); increased penetration of the higher-fee Executive Membership program; and the five dollar increase in our annual membership fee in the second half of 2006 for non-Executive members. Our member renewal rate at the end of 2008 was 87%.

### **Gross Margin**

|  | 2009    | 2008     | 2007    |
|--|---------|----------|---------|
| Gross margin                                       | \$7,554 | \$7,474  | \$6,638 |
| Unusual items                                      |         | <u> </u> | 85      |
| Gross margin, as adjusted                          | \$7,554 | \$7,474  | \$6,723 |
| Gross margin increase                              | 1.1%    | 12.6%    | 6.8%    |
| Gross margin increase, as adjusted                 | 1.1%    | 11.2%    | 8.1%    |
| Gross margin as a percent of net sales             | 10.81%  | 10.53%   | 10.52%  |
| Adjusted gross margin as a percent of adjusted net |         |          |         |
| sales  | 10.81%  | 10.53%   | 10.58%  |

### 2009 vs. 2008

Gross margin, as a percent of net sales, increased 28 basis points compared to 2008. This increase was primarily related to a net 18 basis point increase in our core merchandise departments, primarily in food and sundries, partially offset by a decrease in softlines, and a net seven basis point increase from our warehouse ancillary businesses, primarily our gasoline and pharmacy departments. The majority of this gross margin improvement was due to our lower margin gas business having lower sales penetration, due to the decline in the average selling price per gallon. Increased sales penetration of

the Executive Membership two-percent reward program negatively affected gross margin by six basis points. In addition, gross margin was favorably impacted by nine basis points due to reversing the \$32 LIFO reserve established in the prior year as we experienced net deflation, year-over-year, in the cost of our merchandise inventories.

Foreign currencies, particularly in Canada, the United Kingdom and Korea, weakened against the U.S. dollar, which negatively impacted gross margin for 2009 by approximately \$258.

### 2008 vs. 2007

Gross margin, as a percent of net sales, increased one basis point compared to 2007. Excluding the unusual items affecting net sales and gross margin in 2007, adjusted gross margin as a percent of adjusted net sales decreased five basis points in 2008 as compared to 2007. This decrease was largely due to a net 12 basis point decrease in our warehouse ancillary businesses, particularly in one-hour photo, tire shop and food services, partially offset by an increase in our gasoline business; a \$32, or five basis point LIFO charge, resulting from price increases in certain food items and gasoline; and a three basis point decrease resulting from the increased penetration of the Executive Membership two-percent reward program and increased spending by Executive members. These decreases were partially offset by a net 15 basis point increase from our merchandise departments, particularly fresh foods, food and sundries, Costco Online and our international operations, partially offset by a decrease in softlines.

### Selling, General and Administrative Expenses

|  | 2009    | 2008    | 2007    |
|--|---------|---------|---------|
| Selling, general and administrative expenses   | \$7,252 | \$6,954 | \$6,273 |
| Unusual items                                  |         |         | (47)    |
| SG&A, as adjusted                              | \$7,252 | \$6,954 | \$6,226 |
| SG&A as a percent of net sales                 | 10.38%  | 9.80%   | 9.94%   |
| Adjusted SG&A as percent of adjusted net sales | 10.38%  | 9.80%   | 9.80%   |

### 2009 vs. 2008

SG&A expenses, as a percent of net sales, increased 58 basis points compared to 2008. Increased warehouse operating and central administrative costs, as a percent of net sales, negatively impacted SG&A by approximately 56 basis points, resulting primarily from lower sales levels and higher employee health care costs. Higher stock-based compensation expense had a negative impact of one basis point. In addition, we recorded an adjustment to the net realizable value of the cash surrender value of employee life insurance contracts, which negatively impacted SG&A, as a percent of net sales, by two basis points. The net realizable value of the insurance contracts is largely based on changes in investment assets underlying the policies and is subject to conditions generally affecting equity and debt markets. In 2008, we recorded a \$16 reserve in connection with a legal settlement, which positively impacted the comparison to current year's SG&A expense, as a percent of net sales, by two basis points.

SG&A expenses, as a percent of net sales, for 2009 were adversely impacted by the decrease in the price of gasoline, as it produced a decline in sales dollars without a comparative reduction in labor or other administrative costs. Foreign currencies, particularly in Canada, the United Kingdom, and Korea, weakened against the U.S. dollar, which positively impacted SG&A for 2009 by approximately \$217.

SG&A expenses, as a percent of net sales, decreased 14 basis points compared to 2007. Excluding the unusual items affecting net sales and SG&A expenses in 2007, adjusted SG&A as a percentage of adjusted net sales was comparable to 2007. Warehouse operating and central administrative costs positively impacted adjusted SG&A comparisons, on a net basis, by approximately seven basis points, primarily due to decreased payroll and benefits costs as a percent of adjusted net sales. Stock-based compensation expense negatively impacted adjusted SG&A comparisons by three basis points, primarily due to a higher closing stock price on the date that our October 2007 RSU grant was valued as compared to previous grants. Additionally, in 2008, we recorded a \$16 reserve in connection with a litigation settlement and accrued approximately \$9 for compensation adjustments we made to employees enrolled in our medical and dental plans related to a decision to share a portion of the health plan's savings that we achieved. These two items negatively impacted adjusted SG&A comparisons by four basis points.

### Preopening Expenses

|                     | 2009 | 2008 | 2007 |
|---------------------|------|------|------|
| Preopening expenses | \$41 | \$57 | \$55 |
| Warehouse openings  | 19   | 34   | 30   |

Preopening expenses include costs incurred for startup operations related to new warehouses and the expansion of ancillary operations at existing warehouses. Preopening expenses can vary due to the timing of the opening relative to our year-end, whether the warehouse is owned or leased, whether the opening is in an existing, new, or international market. The decline in 2009 is primarily attributable to fewer warehouse openings.

### Provision for Impaired Assets and Closing Costs, Net

|  | 2009 | 2008 | 2007 |
|--|------|------|------|
| Warehouse closing expenses                         | \$ 9 | \$ 9 | \$16 |
| Impairment of long-lived assets                    | 8    | 10   | _    |
| Net gains on the sale of real property             |      | (19) | (2)  |
| Provision for impaired assets & closing costs, net | \$17 | \$   | \$14 |

This provision primarily includes costs related to impairment of long-lived assets; future lease obligations of warehouses that have been closed or relocated to new facilities; accelerated depreciation, based on the shortened useful life through the expected closing date, on buildings to be demolished or sold and that are not otherwise impaired; and losses or gains resulting from the sale of real property, largely comprised of former warehouse locations.

### 2009 vs. 2008

The net provision for impaired assets and closing costs was a \$17 in 2009, compared to a nominal amount in 2008. The provision in 2009 included charges of \$9 for warehouse closing expenses, and impairment charges of \$8, primarily related to the closing of our two Costco Home locations in July 2009.

The net provision for impaired assets and closing costs was a nominal amount in 2008, compared to \$14 in 2007. The provision in 2008 included charges of \$9 for warehouse closing expenses, and impairment charges of \$10, primarily related to a location in Michigan that was demolished and rebuilt. These charges were offset by \$19 of net gain on the sale of real property, largely former warehouse locations.

At the end of both 2009 and 2008, the reserve for warehouse closing costs was \$5 and primarily related to future lease obligations.

### Interest Expense

|                  | 2009      | 2008  | 2007 |
|------------------|-----------|-------|------|
| Interest expense | <br>\$108 | \$103 | \$64 |

### 2009 vs. 2008

Interest expense primarily relates to our \$900 of 5.3% and \$1,100 of 5.5% Senior Notes (2007 Senior Notes) issued in 2007. The increase in interest expense is primarily due to a decrease in capitalized interest related to reduced new warehouse and remodel construction activity year-over-year.

### 2008 vs. 2007

The increase in interest expense resulted primarily from the issuance of our 2007 Senior Notes in February 2007, partially offset by lower interest expense resulting from the repayment in March 2007 of the \$300 5.5% Senior Notes.

### Interest Income and Other

|                             | 2009  | 2008  | 2007  |
|-----------------------------|-------|-------|-------|
| Interest income             | \$ 27 | \$ 96 | \$128 |
| Earnings of affiliates      | 33    | 42    | 36    |
| Minority interest and other | (15)  | (5)   | 1     |
| Interest Income and other   | \$ 45 | \$133 | \$165 |

### 2009 vs. 2008

The decrease in interest income was largely due to lower interest rates, year-over-year, on our cash and cash equivalents and short-term investment balances resulting from a change in policy to invest primarily in U.S. government and agency securities, which earn a lower interest rate. In addition, we recognized \$12 of other-than-temporary impairment losses on certain securities within our investment portfolio in 2009 compared to an impairment loss of \$5 in 2008. See further discussion in Liquidity and Capital Resources. The decrease in the earnings of affiliates is primarily attributable to our investment in Costco Mexico (a 50%-owned joint venture). Costco Mexico's earnings were lower in 2009, primarily due to the peso weakening against the U.S. dollar. The decrease in minority interest and other is primarily due to a negative \$5 mark-to-market charge in 2009, compared to a \$6 gain in 2008, related to our forward foreign exchange contracts. See the Derivatives section for more information.

The decrease in interest income was largely due to lower interest rates, year-over-year, on our cash and cash equivalents and short-term investment balances. In addition, we recognized \$5 of other-than-temporary impairment losses on certain securities within our investment portfolio. The increase in the earnings of affiliates is primarily attributable to our investment in Costco Mexico (a 50%-owned joint venture).

### Provision for Income Taxes

|                    | 2009   | 2008   | 2007   |
|--------------------|--------|--------|--------|
| Income tax expense | \$ 628 | \$ 716 | \$ 627 |
| Effective tax rate | 36.7%  | 35.8%  | 36.7%  |

The lower tax rate in 2008 was primarily attributable to discrete benefits recognized during the year.

### Net Income

|  | 2        | .009          | 2        | 2008          | 2        | 007           |
|--|----------|---------------|----------|---------------|----------|---------------|
| Net income   | \$       | 1,086         | \$       | 1,283         | \$       | 1,083<br>119  |
| Net income, as adjusted  Diluted earnings per share  Shares used to calculate diluted net income | \$<br>\$ | 1,086<br>2.47 | \$<br>\$ | 1,283<br>2.89 | \$<br>\$ | 1,202<br>2.37 |
| per common share (000's)   | 4        | 40,454        | 4        | 44,240        | 4        | 57,641        |
| increase   |          | (15)%         |          | 22%           |          | 3%            |

### 2009 vs. 2008

Net income for 2009 decreased to \$1,086, or \$2.47 per diluted share, from \$1,283, or \$2.89 per diluted share, during 2008, representing a 15% decrease in diluted net income per share. As previously discussed, foreign currencies, particularly in Canada, the United Kingdom and Korea, weakened against the U.S. dollar, which negatively impacted net income for 2009 by approximately \$83 after-tax, or \$0.19 per diluted share. Additionally, net income for 2009 was negatively impacted by a \$34 pre-tax charge, or approximately \$0.05 per diluted share, related to a proposed litigation settlement concerning our membership renewal policy, as well as a \$23 pre-tax charge, or approximately \$0.03 per diluted share, for an adjustment to the net realizable value of the cash surrender value of employee life insurance contracts. Net income for 2009 was positively impacted by a \$32 pre-tax, or \$0.05 per diluted share, benefit due to the reversal of the LIFO reserve established in 2008.

### 2008 vs. 2007

Net income for 2008 increased to \$1,283, or \$2.89 per diluted share, from \$1,083, or \$2.37 per diluted share, during 2007. The unusual items previously discussed totaled \$119, net of tax, or \$0.26 per diluted share in 2007. Exclusive of these items, earnings in 2007 were \$2.63 per diluted share. Net income per diluted share in 2008 represents an increase of 10% over this adjusted amount. During 2008, we repurchased and retired 13,812,000 shares of common stock, favorably impacting earnings per diluted share by approximately \$0.03.

### LIQUIDITY AND CAPITAL RESOURCES

The following table itemizes components of our most liquid assets at the end of 2009 and 2008 (dollars in millions, except per share data):

|                           | 2009    | 2008    |
|---------------------------|---------|---------|
| Cash and cash equivalents | \$3,157 | \$2,619 |
| Short-term investments    | 570     | 656     |
| Total                     | \$3,727 | \$3,275 |

Our primary sources of liquidity are cash flows generated from warehouse operations and existing cash, cash equivalents, and short-term investment balances, which were \$3,727 and \$3,275 at the end of 2009 and 2008, respectively. Of these balances, approximately \$758 and \$788 at the end of 2009 and 2008, respectively, represented debit and credit card receivables, primarily related to sales in the week prior to the end of the fiscal year.

Net cash provided by operating activities totaled \$2,092 in 2009 compared to \$2,206 in 2008, a decrease of approximately \$114. This decrease was primarily attributable to a decrease in net income of \$197, partially offset by an increase in depreciation and amortization and stock-based compensation of \$90.

Net cash used in investing activities totaled \$1,101 in 2009 compared to \$1,717 in 2008, a decrease of approximately \$616. The decrease in investing activities relates primarily to a \$349 decrease in cash used for additions to property and equipment related to warehouse expansion and remodel projects and a prior year reclassification of \$371 of cash and cash equivalents to short-term investments and other assets on our consolidated balance sheets, explained further below. These activities were partially offset by a decrease in cash provided by the net investment in short-term investments of \$62 as a result of less cash needed to fund our common stock repurchase activity as well as a decrease in cash proceeds from the sale of property and equipment of \$41.

In 2008, one of our enhanced money fund investments, Columbia Strategic Cash Portfolio Fund (Columbia), ceased accepting cash redemption requests and changed to a floating net asset value. In light of the restricted liquidity, we elected to receive a pro-rata allocation of the underlying securities in a separately managed account. We assessed the fair value of these securities through market quotations and review of current investment ratings, as available, coupled with an evaluation of the liquidation value of each investment and its current performance in meeting scheduled payments of principal and interest. During 2009 and 2008, we recognized \$12 and \$5, respectively, of other-than-temporary impairment losses related to these securities. The losses are included in interest income and other in the accompanying consolidated statements of income. At August 30, 2009 and August 31, 2008, the balance of the Columbia fund was \$27 and \$104, respectively, on the consolidated balance sheets.

In 2008, two other enhanced money fund investments, BlackRock Cash Strategies, LLC (BlackRock) and Merrill Lynch Capital Reserve Fund, LLC (Merrill Lynch), ceased accepting redemption requests and commenced liquidation. As of August 31, 2008, the balance of the BlackRock and Merrill Lynch funds was \$82 and \$43, respectively, on the consolidated balance sheets. During 2009, the remaining balances of these funds were liquidated.

During 2008, we reclassified \$371 of these three funds from cash and cash equivalents to short-term investments and other assets. At August 30, 2009, \$24 remained in short-term investments and \$3 remained in other assets on the consolidated balance sheets, reflecting the timing of the expected distributions. At August 31, 2008, \$161 was in short-term investments and \$68 in other assets on the consolidated balance sheets.

The markets relating to these investments remain uncertain, and there may be further declines in the value of these investments that may cause additional losses in future periods.

Net cash used in financing activities totaled \$439 in 2009 compared to \$643 in 2008. The \$204 decrease in net cash used in financing activities primarily resulted from a reduction in the cash used to repurchase common stock of \$826, partially offset by a decrease in the net proceeds from stock-based awards and the excess tax benefit on share-based awards of \$276, a decrease in the net proceeds from short-term borrowings of \$195 as well as a decrease in the cash provided by the issuance of long-term debt of \$103.

The effect of exchange rate changes, reflected in the consolidated statement of cash flows, decreased cash by \$14 in 2009, compared to a decrease of \$7 in 2008. This increase was due primarily to the significant weakening of the Canadian, Korean, and the United Kingdom currencies as compared to the U.S. dollar, during 2009.

#### **Dividends**

In April 2009, our Board of Directors increased our quarterly cash dividend from \$0.16 to \$0.18 per share or \$0.72 on an annualized basis. Our quarterly cash dividends paid in 2009 totaled \$0.68 per share. In 2008, we paid quarterly cash dividends totaling \$0.61 per share.

# **Contractual Obligations**

Our commitments at year-end to make future payments under contractual obligations were as follows, as of August 30, 2009:

|  | Payments Due by Year |              |              |                     |         |
|--|----------------------|--------------|--------------|---------------------|---------|
| Contractual obligations                    | 2010                 | 2011 to 2012 | 2013 to 2014 | 2015 and thereafter | Total   |
| Purchase obligations (merchandise)(1)      | \$3,539              | _            | _            | _                   | \$3,539 |
| Long-term debt(2)                          | 186                  | 1,120        | 126          | 1,432               | 2,864   |
| Operating leases(3)                        | 145                  | 266          | 247          | 1,351               | 2,009   |
| Purchase obligations (property, equipment, |                      |              |              |                     |         |
| services and other)(4)                     | 151                  | 14           | _            | _                   | 165     |
| Construction Commitments                   | 137                  | _            | _            | _                   | 137     |
| Capital lease obligations and other(2)     | 9                    | 11           | 11           | 131                 | 162     |
| Other(5)                                   | 17                   | 4            | 2            | 24                  | 47      |
| Total                                      | \$4,184              | \$1,415      | \$386        | \$2,938             | \$8,923 |

<sup>(1)</sup> Includes open merchandise purchase orders.

- (2) Includes contractual interest payments.
- (3) Operating lease obligations exclude amounts commonly referred to as common area maintenance, taxes, and insurance and have been reduced by \$163 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 \$24 in asset retirement obligations, \$9 in deferred compensation obligations and includes \$14 of current unrecognized tax benefits relating to uncertain tax positions. Amount excludes \$16 of noncurrent unrecognized tax benefits due to uncertainty regarding the timing of future cash payments.

### **Expansion Plans**

Our primary requirement for capital is the financing of land, building, and equipment costs for new and remodeled warehouses. Capital is also 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 \$1,300 during fiscal 2010 for real estate, construction, remodeling, and equipment for warehouses and related operations. 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 approximately 16 to 18 new warehouses in 2010, including one to two relocations of existing warehouses to larger and better located facilities.

# Additional Equity Investments in Subsidiaries and Joint Ventures

Our investments in the Costco Mexico joint venture and in other unconsolidated joint ventures that are less than majority owned are accounted for under the equity method. We did not make any capital contributions to our investment in Costco Mexico (a 50%-owned joint venture) in 2009, 2008, or 2007.

# Bank Credit Facilities and Commercial Paper Programs (all amounts stated in millions, in U.S. dollars)

Credit Line Usage at August 30, 2009 Stand-by Total of LC & Commercial Short-**Applicable Credit Facility** Expiration all Credit Letter of Letter of Term Available Interest **Entity** Description Date **Facilities** Guaranty Credit Borrowing Credit Rate \$ 22 Uncommitted N/A \$22 N/A Stand By Letter of Credit 50 20 30 Uncommitted N/A N/A Commercial Letter of Credit Australia(1) . . . . . . . . . . **Guarantee Line** 8 8 N/A N/A Canada(1) . . . . . Multi-Purpose Line March-10 28 18 10 1.76% Japan(1) ..... 37 8 29 0.64% Revolving Credit February-10 March-10 11 11 Japan(1) ..... **Bank Guaranty** N/A Revolving Credit February-10 37 8 29 0.70% Japan(1) ...... Japan(2) . . . . . . . . Commercial Letter N/A 1 1 N/A of Credit Korea(1) ..... Multi-Purpose Line 10 1 9 3.75% March-10 Taiwan ..... Multi-Purpose Line 15 4 11 2.50% January-10 Taiwan ..... Multi-Purpose Line July-10 15 3 12 2.59% United Kingdom ..... Revolving Credit February-10 66 66 0.82% United Kingdom ..... Uncommitted N/A 33 33 3.05% Money Market Line United Kingdom ..... N/A 49 49 1.50% Uncommitted Overdraft Line United Kingdom(2) . . . . Letter of N/A 3 3 N/A Guarantee United Kingdom ...... Commercial Letter 3 2 N/A 1 N/A of Credit TOTAL . . . . . . . . . . . . . . . . \$388 \$62 \$21 \$16 \$289

<sup>(1)</sup> The U.S. parent company, Costco Wholesale Corporation, guarantees this entity's credit facility.

<sup>(2)</sup> The letter of guarantee is fully cash-collateralized by the subsidiary.

Credit Line Usage at August 31, 2008

| Entity            | Credit Facility<br>Description              | Expiration<br>Date | Total of<br>all Credit<br>Facilities | Stand-by<br>LC &<br>Letter of<br>Guaranty | Commercial<br>Letter of<br>Credit | Short<br>Term<br>Borrowing | Available<br>Credit | Applicable<br>Interest<br>Rate |
|-------------------|---|--------------------|--------------------------------------|---|-----------------------------------|----------------------------|---------------------|--------------------------------|
| U.S               | Uncommitted<br>Stand By<br>Letter of Credit | N/A                | \$ 25                                | \$25                                      | \$—                               | \$ —                       | \$ —                | N/A                            |
| U.S               | Uncommitted Commercial Letter of Credit     | N/A                | 160                                  | _   | 45                                | _                          | 115                 | N/A                            |
| Australia(1)      | Guarantee Line                              | N/A                | 9                                    | 3   |                                   |                            | 6                   | N/A                            |
| Canada(1, 3)      | Multi-Purpose Line                          | March-09           | 142                                  | 20  |                                   | 85                         | 37                  | 3.43%                          |
| Japan(1)          |   | February-09        | 32                                   | _   | _                                 | 4                          | 28                  | 1.00%                          |
| Japan(1)          |   | February-09        | 9                                    | 9   | _                                 | _                          | _                   | N/A                            |
| Japan(1)          |   | February-09        | 32                                   | _   | _                                 | 14                         | 18                  | 1.04%                          |
| Korea(1)          | Multi-Purpose Line                          | March-09           | 11                                   | 1   | 1                                 | _                          | 9                   | 6.53%                          |
| Taiwan            | Multi-Purpose Line                          | January-09         | 16                                   | 5   | _                                 | _                          | 11                  | 4.50%                          |
| Taiwan            | Multi-Purpose Line                          | July-09            | 16                                   | 2   | _                                 | _                          | 14                  | 4.59%                          |
| United Kingdom    | Revolving Credit                            | February-10        | 73                                   | _   | _                                 | _                          | 73                  | 5.67%                          |
| United Kingdom    | Uncommitted                                 | May-09             | 37                                   | _   | _                                 | 31                         | 6                   | 5.36%                          |
| United Kingdom    | Money Market<br>Overdraft Line              | May-09             | 64                                   |   |                                   |                            | 64                  | 6.00%                          |
| <u> </u>          |   | •                  |                                      | 4   |                                   | <del></del>                | 04                  | 0.00 / <sub>0</sub>            |
| United Kingdom(2) | Guarantee                                   | N/A                | 4                                    | 4   | _                                 | _                          | _                   | IN/A                           |
| United Kingdom    | Commercial Letter of Credit                 | N/A                | 3                                    |   | 1                                 |                            | 2                   | N/A                            |
|                   | TOTAL                                       |                    | \$633                                | \$69                                      | \$47                              | \$134                      | \$383               |                                |

<sup>(1)</sup> This entity's credit facility is guaranteed by the U.S. parent company, Costco Wholesale Corporation.

Note: We have credit facilities (for commercial and standby letters of credit) totaling \$116 and \$239 as of August 30, 2009 and August 31, 2008, respectively. The outstanding commitments under these facilities at August 30, 2009 and August 31, 2008, totaled \$83 and \$116, respectively, including \$62 and \$69, respectively, in standby letters of credit. For those entities with multi-purpose lines, any issuance of either letters of credit (standby and/or commercial) or short-term borrowings will result in a corresponding decrease in available credit.

# Financing Activities

In July 2009, we entered into a capital lease for a new warehouse building location and recorded a liability in the amount of \$72, representing the net present value of \$150 in aggregate future minimum lease payments at an imputed interest rate of 5.4%. This lease expires and becomes subject to a renewal clause in 2040. As of August 30, 2009, \$71 is included in long-term debt and \$1 in the current portion of long-term debt in our consolidated balance sheets. We have other minor capital lease obligations that amounted to \$5 at the end of 2009 and 2008.

In June 2008, our wholly-owned Japanese subsidiary entered into a ten-year term loan in the amount of \$32, with a variable rate of interest of Yen TIBOR (6-month) plus a 0.35% margin (0.95% and 1.24% at August 30, 2009 and August 31, 2008, respectively) on the outstanding balance. The net proceeds were used to repay the 1.187% Promissory Notes due in July 2008 and for general corporate purposes. Interest is payable semi-annually in December and June and principal is due in June 2018.

<sup>(2)</sup> The letter of guarantee is fully cash-collateralized by the United Kingdom subsidiary.

<sup>(3)</sup> The amount shown for short-term borrowings under this facility is net of a note issue discount, which is excluded from the available credit amount.

In October 2007, our wholly-owned Japanese subsidiary issued promissory notes through a private placement in the amount of \$69, bearing interest at 2.695%. Interest is payable semi-annually, and principal is due in October 2017. The proceeds were used to repay the 2.07% Promissory Notes in October 2007 and for general corporate purposes.

In February 2007, we issued \$900 of 5.3% Senior Notes due March 15, 2012 at a discount of \$2 and \$1,100 of 5.5% Senior Notes due March 15, 2017 at a discount of \$6 (together, the 2007 Senior Notes). Interest on the 2007 Senior Notes is payable semi-annually on March 15 and September 15 of each year. The discount and issuance costs associated with the 2007 Senior Notes are being amortized to interest expense over the terms of those notes. At our option, we may redeem the 2007 Senior Notes at any time, in whole or in part, at a redemption price plus accrued interest. The redemption price is equal to the greater of 100% of the principal amount of the 2007 Senior Notes to be redeemed, or the sum of the present values of the remaining scheduled payments of principal and interest to maturity. Additionally, we will be required to make an offer to purchase the 2007 Senior Notes at a price of 101% of the principal amount plus accrued and unpaid interest to the date of repurchase, upon certain events as defined by the terms of the 2007 Senior Notes.

In April 2003, our wholly-owned Japanese subsidiary issued promissory notes bearing interest at 0.92% in the amount of \$43, through a private placement. Interest is payable semi-annually and principal is due in April 2010. In November 2002, our wholly-owned Japanese subsidiary issued promissory notes bearing interest at 0.88% in the aggregate amount of \$32, through a private placement. Interest is payable semi-annually and principal is due in November 2009. The U.S. parent company, Costco Wholesale Corporation guarantees all of the promissory notes issued by our wholly-owned Japanese subsidiary.

In August 1997, we sold \$900 principal amount at maturity 3.5% Zero Coupon Convertible Subordinated Notes (Zero Coupon Notes) due in August 2017. The Zero Coupon Notes were priced with a yield to maturity of 3.5%, resulting in gross proceeds of \$450. The current Zero Coupon Notes outstanding are convertible into a maximum of 961,000 shares of Costco Common Stock shares at an initial conversion price of \$22.71. Holders of the Zero Coupon Notes may require us to purchase the Zero Coupon Notes (at the discounted issue price plus accrued interest to date of purchase) in August 2012. At our option, we may redeem the Zero Coupon Notes (at the discounted issue price plus accrued interest to date of redemption) any time after August 2002. As of August 30, 2009, \$858 in principal amount of the Zero Coupon Notes had been converted by note holders to shares of Costco Common Stock, of which \$25, \$1, and \$61 in principal were converted in 2009, 2008, and 2007 respectively, or \$19 and \$42 in 2009 and 2007, respectively, after factoring in the related debt discount. In 2008, the conversion of principle for Zero Coupon Notes after factoring the related debt discount was not significant.

#### Derivatives

Effective November 24, 2008, we adopted the disclosure requirements of Statement of Financial Accounting Standards (SFAS) No. 161, "Disclosures about Derivative Instruments and Hedging Activities—an Amendment of Financial Accounting Standards Board (FASB) Statement No. 133" (SFAS 161). We follow SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities (as amended)" (SFAS 133), in accounting for derivative and hedging activities.

We are exposed to foreign currency exchange-rate fluctuations in the normal course of our business, which we manage in part through the use of forward foreign exchange contracts, seeking to hedge the impact of fluctuations of foreign exchange on known future expenditures denominated in a foreign currency. The forward foreign exchange contracts are entered into primarily to hedge U.S. dollar merchandise inventory expenditures. Currently, these instruments do not qualify for derivative hedge

accounting. We use these instruments to mitigate risk and do not intend to engage in speculative transactions. These contracts do not contain any credit-risk-related contingent features.

We seek to manage the counterparty risk associated with these forward foreign exchange contracts by limiting transactions to counterparties with which we have established banking relationships. There can be no assurance, however, that this effectively mitigates counterparty risk. In addition, the contracts are limited to a time period of less than one year. See Note 1 and Note 3 to the consolidated financial statements included in this Report for additional information related to these contracts.

We are exposed to risks due to fluctuations in energy prices, particularly electricity and natural gas, which we seek to partially mitigate through the use of fixed-price contracts with counterparties for approximately 24% of our warehouses and other facilities in the U.S. and Canada. We also enter into variable-priced contracts for some purchases of natural gas and fuel for our gas stations on an index basis. These contracts qualify for treatment as "normal purchase or normal sales" under SFAS 133 and require no mark-to-market adjustment.

# Off-Balance Sheet Arrangements

With the exception of our operating leases, 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 September and November of 2007, our Board of Directors approved \$300 and \$1,000, respectively, of stock repurchases, which expire in August 2010 and November 2010, respectively. In July 2008, our Board of Directors approved an additional \$1,000, which expires in July 2011, bringing total authorizations by our Board of Directors since inception of the program in 2001 to \$6,800.

During 2009, we repurchased 895,000 shares at an average price of \$63.84 per share totaling approximately \$57. During 2008, we repurchased 13,812,000 shares of common stock, at an average price of \$64.22 per share, totaling approximately \$887. The remaining amount available to be purchased under our approved plan was \$2,002 at the end of 2009. 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 Policies

The preparation of our financial statements 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, warehouse closing costs, insurance/self-insurance liabilities, and income taxes. We base our estimates on historical experience and on other assumptions that we believe to be reasonable.

# Revenue Recognition

We generally recognize sales, 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. Amounts collected from members, which under common trade practices are referred to as sales taxes, are recorded on a net basis.

We evaluate the criteria of the FASB Emerging Issues Task Force (EITF) 99-19, "Reporting Revenue Gross as a Principal Versus Net as an Agent," in determining 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 is 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.

Membership fee revenue represents annual membership fees paid by substantially all of our members. We account for membership fee revenue on a deferred basis, whereby revenue is recognized ratably over the one-year membership period.

Our Executive members qualify for a 2% reward (which can be redeemed only at Costco warehouses), up to a maximum of \$500 per year, on all qualified purchases made at Costco. We account for this 2% reward as a reduction in sales, with the related liability being classified within other current liabilities. The sales reduction and corresponding liability are computed after giving effect to the estimated impact of non-redemptions based on historical data.

#### Investments

Investments are reviewed quarterly for indicators of other-than-temporary impairment. This determination requires significant judgment. In making this judgment, we employ a systematic methodology that considers available quantitative and qualitative evidence in evaluating potential impairment of our investments. 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, and/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 of accounting, and are stated using the last-in, first-out (LIFO) method for substantially all U.S. merchandise inventories. Merchandise inventories for all other foreign operations are primarily valued by the retail inventory method of accounting 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 expected annual effect of inflation, and these estimates are adjusted to actual results determined at year-end. At the end of 2008, due to overall net inflationary trends, merchandise inventories valued at LIFO were lower than the FIFO value, resulting in a \$32 charge to merchandise costs. During 2009, due to overall deflationary trends, we recorded a \$32 benefit to merchandise costs to adjust inventories valued at LIFO. At the end of 2009 and 2007, merchandise inventories valued at LIFO after considering the lower of cost or market principle.

We provide for estimated inventory losses 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 and Warehouse Closing costs

We periodically evaluate our long-lived assets for indicators of impairment, such as a decision to relocate or close a warehouse location. 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.

We provide estimates for warehouse closing costs for both leased and owned locations to be closed or relocated. A considerable amount of judgment is involved in determining any impairment or our net liability, particularly related to the estimated sales price of owned locations and the potential sublease income at leased locations. These estimates are based on real estate conditions in the markets and our experience in those markets. We make assumptions about the average period of time it would take to sublease the location and the amount of potential sublease income for each leased location. We reassess our liability each quarter and adjust our liability accordingly when our estimates change.

#### Insurance/Self Insurance Liabilities

We use a combination of insurance and self-insurance mechanisms, including a wholly-owned captive insurance entity and participation in a reinsurance pool, to provide for potential liabilities for workers' compensation, general liability, property damage, director 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

We adopted FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109" (FIN 48), which sets out criteria for the use of judgment in assessing the timing and amounts of deductible and taxable items, at the beginning of 2008. 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 of uncertain tax positions are recorded in our consolidated financial statements only after determining a more-likely-than-not probability that the uncertain tax positions will withstand challenge, if any, 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 discussion of Recent Accounting Pronouncements in Note 1 to the consolidated financial statements included on page 61 of this Report.

#### **Quantitative and Qualitative Disclosures About Market Risk**

We are exposed to financial market risk resulting from fluctuations in interest and foreign currency exchange rates. We do not engage in speculative or leveraged transactions, nor hold or issue financial instruments for trading purposes. The current condition of the financial markets, however, has rendered identifiable risks less predictable, and liquidity concerns and credit risks have increased.

#### Interest Rate Risk

Our exposure to market risk for changes in interest rates relates primarily to our investment holdings that are diversified amongst money market funds, debt securities, corporate notes and bonds, and enhanced money funds 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 while continuing to generate yields. A revised investment policy was approved in December 2007 by our Board of Directors, limiting future investments 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.

The investment policies of our subsidiaries are consistent with our primary objective to preserve principal while continuing to generate yields. Our wholly owned 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+.

All of our foreign subsidiaries' investments are primarily in money market funds, investment grade securities, bankers' acceptances, bank certificates of deposit and term deposits, all denominated in their local currencies. Additionally, our Canadian subsidiary may invest a portion of its investments in U.S. dollar investment grade securities and bank term deposits to meet current U.S. dollar obligations.

All of the investment policies of the Company and subsidiaries are reviewed at least annually.

Because most of our investments in cash and cash equivalents are of a short-term nature, if interest rates were to increase or decrease, the impact would likely be immaterial to our financial statements. Based on our overnight investments and bank balances within cash and cash equivalents at the end of 2009 and 2008, a 100 basis point increase or decrease in interest rates would result in an increase or decrease of approximately \$24 and \$18 (pre-tax), respectively, to interest income on an annual basis. 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 and short-term debt may vary as a result of future business requirements, market conditions and other factors. As of the end of 2009, our fixed-rate long-term debt included: \$42 principal amount at maturity of 3.5% Zero Coupon Convertible Subordinated Notes carried at \$32; \$900 of 5.3% Senior Notes carried at \$899; and \$1,100 of 5.5% Senior Notes carried at \$1,096, and additional notes and capital lease obligations totaling \$228. Additionally, our variable rate long-term debt included a 0.35% over Yen Tibor (6-month) Term Loan of \$32. 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 3 to the consolidated financial statements included in Part II, Item 8 of this Report for more information on our long and short-term debt.

# Foreign Currency-Exchange Risk

Our foreign subsidiaries conduct limited transactions in their non-functional currencies, which exposes us to fluctuations in foreign currency exchange rates. We manage these fluctuations, in part, through the use of forward foreign exchange contracts, seeking to hedge the impact of fluctuations of foreign exchange on known future expenditures denominated in a foreign currency.

As of August 30, 2009, and August 31, 2008, we held forward foreign exchange contracts with a notional amount of \$183 and \$90, respectively, and a fair value liability of \$2 and a fair value asset of \$5, respectively, on the consolidated balance sheets. A hypothetical 10% strengthening of the functional currency compared to the non-functional currency exchange rates at August 30, 2009 and August 31, 2008 would have decreased the fair value of the contracts by \$18 and \$10, respectively.

# DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

A list of Directors and nominees for Director is included in Costco's Proxy Statement for our Annual Meeting of Shareholders to be held on January 28, 2010. A list of the names and positions of the Directors, as well as the Executive and Senior Officers of our Company, appears on page 90 of this report. The following is a list of the names, ages and positions of the executive officers of our Company.

| Name                 | Position With Company   | Executive<br>Officer<br>Since | Age |
|----------------------|---|-------------------------------|-----|
| James D. Sinegal     | President and Chief Executive Officer. Mr. Sinegal is a co-<br>founder of the Company and has been a director since its<br>inception.   | 1983                          | 73  |
| Jeffrey H. Brotman   | Chairman of the Board. Mr. Brotman is a co-founder of the Company and has been a director since its inception.  | 1983                          | 67  |
| Richard D. DiCerchio | Sr. Executive Vice President, Chief Operating Officer,<br>Global Operations, Distribution and Construction,<br>Manufacturing and Ancillary Businesses. Mr. DiCerchio<br>has been a Senior Executive Vice President of the<br>Company since 1997 and has been a director since 1986. | 1986                          | 66  |
| Richard A. Galanti   | Executive Vice President and Chief Financial Officer.<br>Mr. Galanti has been a director of the Company since<br>January 1995.  | 1993                          | 53  |
| W. Craig Jelinek     | Executive Vice President, Chief Operating Officer, Merchandising. Mr. Jelinek has been Executive Vice President, Chief Operating Officer, Merchandising since February 2004.  | 1995                          | 57  |
| Paul G. Moulton      | Executive Vice President, Real Estate Development.  | 2001                          | 58  |
| Joseph P. Portera    | Executive Vice President, Chief Operating Officer, Eastern and Canadian Divisions.  | 1994                          | 57  |
| Douglas W. Schutt    | Executive Vice President, Chief Operating Officer— Northern and Midwest Division. Mr. Schutt has been Executive Vice President, Chief Operating Officer— Northern and Midwest Division, since February 2004.  | 2004                          | 50  |
| Thomas K. Walker     | Executive Vice President, Construction, Distribution and Traffic. Mr. Walker has been Executive Vice President, Construction, Distribution and Traffic since February 2004.   | 2004                          | 69  |
| Dennis R. Zook       | Executive Vice President, Chief Operating Officer—Southwest and Mexico Divisions.   | 1993                          | 60  |

All executive officers have 25 or more years of service with the Company, with the exception of Mr. Moulton and Mr. Schutt, each of whom has 24 years of service.

The Company has 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.

# **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.

### **MANAGEMENT'S REPORTS**

# Management's Report on the Consolidated Financial Statements

Our management is responsible for the preparation, integrity and objectivity of the accompanying consolidated financial statements and the related financial information. The 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. Our management also prepared the related financial information included in this Annual Report on Form 10-K and is responsible for its accuracy and consistency with the 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 financial statements present our financial position, results of operations and cash flows in accordance with U.S. generally accepted accounting principles.

# **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 year that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

The certifications of our Chief Executive Officer and Chief Financial Officer required by Section 302 of the Sarbanes-Oxley Act of 2002 are filed as Exhibit 31.1 in our Form 10-K.

# 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 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 August 30, 2009, using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control—Integrated Framework. Based on its assessment, management has concluded that our internal control over financial reporting was effective as of August 30, 2009.

James D. Sinegal

President

Chief Executive Officer

m Swegel

Richard A. Galanti Executive Vice President

Chief Financial Officer

#### REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders Costco Wholesale Corporation:

We have audited the accompanying consolidated balance sheets of Costco Wholesale Corporation and subsidiaries as of August 30, 2009 and August 31, 2008 and the related consolidated statements of income, stockholders' equity and comprehensive income and cash flows for each of the 52-week periods ended August 30, 2009, August 31, 2008 and September 2, 2007. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Costco Wholesale Corporation and subsidiaries as of August 30, 2009 and August, 31, 2008, and the results of their operations and their cash flows for the 52-week periods ended August 30, 2009, August 31, 2008 and September 2, 2007, in conformity with U.S. generally accepted accounting principles.

Effective September 3, 2007, the beginning of the Company's fiscal year ended August 31, 2008, the Company adopted Financial Accounting Standards Board Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of August 30, 2009, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated October 16, 2009 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.



Seattle, Washington October 16, 2009

#### REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders Costco Wholesale Corporation:

We have audited Costco Wholesale Corporation's internal control over financial reporting as of August 30, 2009, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying management's annual report on internal control over financial reporting included in Item 9A. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of August 30, 2009, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of the Company as of August 30, 2009 and August 31, 2008, and the related consolidated statements of income, stockholders' equity and comprehensive income, and cash flows for each of the 52-week periods ended August 30, 2009, August 31, 2008 and September 2, 2007, and our report dated October 16, 2009 expressed an unqualified opinion on those consolidated financial statements.



Seattle, Washington October 16, 2009

# **CONSOLIDATED BALANCE SHEETS**

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

|   | August 30,<br>2009                                   | August 31,<br>2008                                   |
|---|--|--|
| ASSETS  |  |  |
| CURRENT ASSETS  Cash and cash equivalents Short-term investments Receivables, net Merchandise inventories Deferred income taxes and other current assets                                | \$ 3,157<br>570<br>834<br>5,405<br>371               | \$ 2,619<br>656<br>748<br>5,039<br>400               |
| Total current assets  | 10,337   | 9,462  |
| PROPERTY AND EQUIPMENT  | 0.044  | 0.047  |
| Land Buildings, leasehold and land improvements Equipment and fixtures Construction in progress   | 3,341<br>8,453<br>3,265<br>264                       | 3,217<br>7,749<br>3,057<br>306                       |
| Less accumulated depreciation and amortization  | 15,323<br>(4,423)                                    | 14,329<br>(3,974)                                    |
| Net property and equipment  | 10,900   | 10,355   |
| OTHER ASSETS  | 742  | 865  |
| TOTAL ASSETS  | \$21,979   | \$20,682   |
| LIABILITIES AND STOCKHOLDERS' EQUITY  |  |  |
| CURRENT LIABILITIES   |  |  |
| Short-term borrowings Accounts payable Accrued salaries and benefits Accrued sales and other taxes Deferred membership fees Current portion of long-term debt Other current liabilities | \$ 16<br>5,450<br>1,418<br>302<br>824<br>81<br>1,190 | \$ 134<br>5,225<br>1,321<br>283<br>748<br>6<br>1,157 |
| Total current liabilities   | 9,281<br>2,206<br>388                                | 8,874<br>2,206<br>328                                |
| Total liabilities   | 11,875   | 11,408   |
| COMMITMENTS AND CONTINGENCIES MINORITY INTEREST   | 86   | 82   |
| STOCKHOLDERS' EQUITY  Preferred stock \$.005 par value; 100,000,000 shares authorized; no shares issued and outstanding   | _  | _  |
| 435,974,000 and 432,513,000 shares issued and outstanding   | 2  | 2  |
| Additional paid-in capital  | 3,811<br>104   | 3,543<br>286   |
| Retained earnings   | 6,101  | 5,361  |
| Total stockholders' equity  | 10,018   | 9,192  |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY  | <u>\$21,979</u>                                      | \$20,682   |

# CONSOLIDATED STATEMENTS OF INCOME (dollars in millions, except per share data)

|  | en<br>Augı | veeks<br>ded<br>ust 30,<br>009 | er<br>Aug | weeks<br>nded<br>just 31,<br>2008 | Septe | weeks<br>nded<br>ember 2,<br>2007 |
|--|------------|--------------------------------|-----------|-----------------------------------|-------|-----------------------------------|
| REVENUE  |            |                                |           |                                   |       |                                   |
| Net sales  Membership fees                           | \$ 6       | 69,889<br>1,533                | \$        | 70,977<br>1,506                   | \$    | 63,088<br>1,313                   |
| Total revenue  | 7          | 71,422                         |           | 72,483                            |       | 64,401                            |
| Merchandise costs                                    | (          | 62,335                         |           | 63,503                            |       | 56,450                            |
| Selling, general and administrative                  |            | 7,252                          |           | 6,954                             |       | 6,273                             |
| Preopening expenses                                  |            | 41                             |           | 57                                |       | 55                                |
| Provision for impaired assets and closing costs, net |            | 17                             |           |                                   |       | 14                                |
| Operating income  OTHER INCOME (EXPENSE)             |            | 1,777                          |           | 1,969                             |       | 1,609                             |
| Interest expense                                     |            | (108)                          |           | (103)                             |       | (64)                              |
| Interest income and other                            |            | 45                             |           | 133                               |       | 165                               |
| INCOME BEFORE INCOME TAXES                           |            | 1,714                          |           | 1,999                             |       | 1,710                             |
| Provision for income taxes                           |            | 628                            |           | 716                               |       | 627                               |
| NET INCOME   | \$         | 1,086                          | \$        | 1,283                             | \$    | 1,083                             |
| NET INCOME PER COMMON SHARE:                         |            |                                |           |                                   |       |                                   |
| Basic  | \$         | 2.50                           | \$        | 2.95                              | \$    | 2.42                              |
| Diluted  | \$         | 2.47                           | \$        | 2.89                              | \$    | 2.37                              |
| Shares used in calculation (000's)                   |            | _                              |           |                                   |       | _                                 |
| Basic  | 43         | 33,988                         | 4         | 34,442                            | 4     | 47,659                            |
| Diluted  | 44         | 10,454                         | 4         | 44,240                            | 4     | 57,641                            |
| Dividends per share                                  | \$         | 0.68                           | \$        | 0.61                              | \$    | 0.55                              |

# CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME

(dollars in millions, except share data)

|   | Commo          | n Stock | Additional<br>Paid-In | Accumulated<br>Other<br>Comprehensive | Retained |           |
|---|----------------|---------|-----------------------|---------------------------------------|----------|-----------|
|   | Shares         | Amount  | Capital               | Income                                | Earnings | Total     |
| BALANCE AT SEPTEMBER 3, 2006 Comprehensive Income:                      | 462,279        | \$ 2    | \$2,823               | \$ 278                                | \$ 6,041 | \$ 9,144  |
| Net income Foreign currency translation                                 | _              | _       | _                     | _                                     | 1,083    | 1,083     |
| adjustment and other  | _              | _       | _                     | 93                                    | _        | 93        |
| Comprehensive income  | 0.705          |         | 254                   |                                       |          | 1,176     |
| tax benefits and other  Conversion of convertible notes                 | 9,735<br>1,389 | _       | 351<br>42             | _                                     | _        | 351<br>42 |
| Stock repurchase  | (36,390)       |         | (233)                 | _                                     | (1,746)  | (1,979)   |
| Stock-based compensation  | (50,550)       |         | 135                   | _                                     | (1,740)  | 135       |
| Cash dividends  | _              | _       | _                     | _                                     | (246)    | (246)     |
| BALANCE AT SEPTEMBER 2, 2007 Cumulative effect of adjustments resulting | 437,013        | 2       | 3,118                 | 371                                   | 5,132    | 8,623     |
| from the adoption of FIN 48, net of tax                                 | _              | _       | _                     | _                                     | (6)      | (6)       |
| Adjusted balance at September 2, 2007 Comprehensive Income:             | 437,013        | 2       | 3,118                 | 371                                   | 5,126    | 8,617     |
| Net incomeForeign currency translation                                  | _              | _       | _                     | _                                     | 1,283    | 1,283     |
| adjustment and other  | _              | _       | _                     | (85)                                  | _        | (85)      |
| Comprehensive income  | 0.000          |         | 200                   |                                       |          | 1,198     |
| tax benefits and other  | 9,299<br>13    | _       | 363                   | _                                     | _        | 363       |
| Conversion of convertible notes   | (13,812)       | _       | (104)                 | _                                     | (783)    | (887)     |
| Stock-based compensation  | (13,012)       |         | 166                   | _                                     | (763)    | 166       |
| Cash dividends  | _              | _       | _                     | _                                     | (265)    | (265)     |
| BALANCE AT AUGUST 31, 2008  | 432,513        | 2       | 3,543                 | 286                                   | 5,361    | 9,192     |
| Comprehensive Income: Net income  | _              | _       | _                     | _                                     | 1,086    | 1,086     |
| Foreign currency translation adjustment and other                       | _              | _       | _                     | (182)                                 | _        | (182)     |
| Comprehensive income  |                |         |                       |                                       |          | 904       |
| tax benefits and other  | 3,794          | _       | 75                    | _                                     | _        | 75        |
| Conversion of convertible notes   | 562            | _       | 19                    | _                                     | _        | 19        |
| Stock repurchase  | (895)          | _       | (7)                   | _                                     | (50)     | (57)      |
| Stock-based compensation  | _              | _       | 181                   | _                                     |          | 181       |
| Cash dividends  |                |         |                       |                                       | (296)    | (296)     |
| BALANCE AT AUGUST 30, 2009  | 435,974        | \$ 2    | \$3,811               | <u>\$ 104</u>                         | \$ 6,101 | \$10,018  |

# CONSOLIDATED STATEMENTS OF CASH FLOWS (dollars in millions)

|  | 52 Weeks<br>ended<br>August 30,<br>2009 | 52 Weeks<br>ended<br>August 31,<br>2008 | 52 Weeks<br>ended<br>September 2,<br>2007 |
|--|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES   |   |   |   |
| Net income   | \$ 1,086                                | \$ 1,283                                | \$ 1,083                                  |
| Depreciation and amortization  | 728                                     | 653                                     | 566                                       |
| Stock-based compensation   | 181                                     | 166                                     | 135                                       |
| Undistributed equity earnings in joint ventures                                      | (33)<br>(2)                             | (41)<br>(22)                            | (34)                                      |
| Provision on impaired assets   | 11                                      | 10                                      | _   |
| Minority interest earnings   | 13                                      | 12                                      | 6   |
| Accretion of discount on long-term debt  | 3                                       | 3                                       | 3   |
| Excess tax benefit on share based awards   | (2)                                     | (41)                                    | (25)                                      |
| Other-than-temporary impairment loss on investments                                  | 12<br>22                                | 5<br>8                                  | (5)                                       |
| Change in deferred income taxes  | 70                                      | 21                                      | (93)                                      |
| Change in receivables, other current assets, deferred membership fees, accrued       | 142                                     | 245                                     | 289                                       |
| and other current liabilities  | (394)                                   | (192)                                   | (273)                                     |
| Increase in accounts payable   | 255                                     | 96                                      | 435                                       |
| Net cash provided by operating activities  | 2,092                                   | 2,206                                   | 2,087                                     |
| CASH FLOWS FROM INVESTING ACTIVITIES   |   |   |   |
| Additions to property and equipment, net of \$20, \$21, and \$42 of non-cash capital |   | >                                       |   |
| expenditures for 2009, 2008 and 2007, respectively                                   | (1,250)<br>7                            | (1,599)<br>48                           | (1,386)<br>14                             |
| Purchases of short-term investments  | (1,806)                                 | (1,507)                                 | (1,161)                                   |
| Maturities of short-term investments   | `1,780 <sup>′</sup>                     | `1,561                                  | `1,418 <sup>′</sup>                       |
| Sales of investments   | 183                                     | 165                                     | 496                                       |
| Change in certain other assets and other, net  | (9)<br>(6)                              | (14)<br>(371)                           | (36)                                      |
| Net cash used in investing activities  | (1,101)                                 | (1,717)                                 | (655)                                     |
| CASH FLOWS FROM FINANCING ACTIVITIES   |   |   |   |
| Change in bank checks outstanding  | (22)                                    | 49                                      | 23  |
| Repayments of short-term borrowings  | (1,777)                                 | (5,163)                                 | (2,035)                                   |
| Proceeds from short-term borrowings  | 1,669                                   | 5,250<br>103                            | 2,045<br>1,994                            |
| Repayments of long-term debt   | (6)                                     | (69)                                    | (307)                                     |
| Cash dividend payments   | (296)                                   | (265)                                   | (246)                                     |
| Distribution to minority interests   | (9)                                     | <u> </u>                                | <br>25                                    |
| Excess tax benefit on share based awards   | 2<br>69                                 | 306                                     | 304                                       |
| Repurchases of common stock  | (69)                                    | (895)                                   | (1,978)                                   |
| Net cash used in financing activities  | (439)                                   | (643)                                   | (175)                                     |
| EFFECT OF EXCHANGE RATE CHANGES ON CASH  | (14)                                    | (7)                                     | 12  |
| Net increase/(decrease) in cash and cash equivalents                                 | 538<br>2,619                            | (161)<br>2,780                          | 1,269<br>1,511                            |
| CASH AND CASH EQUIVALENTS END OF YEAR  | \$ 3,157                                | \$ 2,619                                | \$ 2,780                                  |
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:                                    |   |   |   |
| Cash paid during the year for:   |   |   |   |
| Interest (reduced by \$8, \$16, and \$11 interest capitalized for 2009, 2008 and     | ¢ 104                                   | ¢ 100                                   | Φ 0                                       |
| 2007, respectively)  | \$ 104<br>\$ 565                        | \$ 106<br>\$ 615                        | \$ 9<br>\$ 786                            |
| SUPPLEMENTAL DISCLOSURE OF NON-CASH FINANCING ACTIVITIES:                            | Ψ 000                                   | Ψ 010                                   | Ψ 100                                     |
| Common stock issued upon conversion of 3.5% Zero Coupon Convertible                  | Φ 40                                    | Φ                                       | Φ 40                                      |
| Subordinated Notes  Property acquired under a capital lease                          | \$ 19<br>\$ 72                          | \$ —<br>\$ —                            | \$ 43<br>\$ —                             |
| r roporty adquired under a dapital leade   | Ψ 12                                    | Ψ —                                     | Ψ —                                       |

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (dollars in millions, except share data)

# Note 1—Summary of Significant Accounting Policies

#### Basis of Presentation

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

Costco operates membership warehouses that offer low prices on a limited selection of nationally branded and select private label products in a wide range of merchandise categories in no-frills, self-service facilities. At August 30, 2009, Costco operated 527 warehouses in 40 states and Puerto Rico (406 locations), nine Canadian provinces (77 locations), the United Kingdom (21 locations), Japan (nine locations), Korea (seven locations), Taiwan (six locations) and Australia (one location), as well as 32 locations in Mexico, through a 50%-owned joint venture.

In connection with the adoption of Financial Accounting Standards Board (FASB) Interpretation No. 48, "Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109" (FIN 48), the Company adjusted its beginning retained earnings balance for fiscal 2008 in the accompanying consolidated financial statements. See Note 9 for further discussion.

# Fiscal Year End

The Company's fiscal year ends on the Sunday closest to August 31. References to 2009, 2008 and 2007 relate to the 52-week fiscal years ended August 30, 2009, August 31, 2008, and September 2, 2007, respectively.

#### Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

#### Reclassifications

Certain reclassifications have been made to prior fiscal year amounts or balances to conform to the presentation adopted in the current fiscal year.

#### Cash and Cash Equivalents

The Company considers as cash and cash equivalents all highly liquid investments with a maturity of three months or less at the date of purchase and proceeds due from credit and debit card transactions with settlement terms of less than one week. Of the total cash and cash equivalents of \$3,157 at August 30, 2009 and \$2,619 at August 31, 2008, credit and debit card receivables were \$758 and \$788, respectively.

#### Short-term Investments

In general, short-term investments have a maturity of three months to five years at the date of purchase. Investments with maturities beyond five years may be classified as short-term based on their highly liquid nature and because such marketable securities represent the investment of cash that is available for current operations. Short-term investments classified as available-for-sale are recorded at fair value as described in Notes 2 and 3, using the specific identification method with the unrealized gains and losses reflected in accumulated other comprehensive income until realized. Realized gains and losses from the sale of available-for-sale securities, if any, are determined on a specific identification basis.

# Receivables, net

Receivables consist of the following at the end of 2009 and 2008:

| 2009         | 2008                         |
|--------------|------------------------------|
| \$418        | \$361                        |
| 169          | 152                          |
| 95           | 89                           |
| 82           | 84                           |
| 73           | 66                           |
| (3)          | (4)                          |
| <u>\$834</u> | <u>\$748</u>                 |
|              | 169<br>95<br>82<br>73<br>(3) |

Vendor receivable balances are generally presented on a gross basis separate from any related payable due. In certain circumstances, these receivables may be settled against the related payable to that vendor.

Reinsurance receivables are held by the Company's wholly-owned captive insurance subsidiary. The receivable balance represents amounts ceded to the reinsurance pool, and are reflected on a gross basis, separate from the amounts assumed, which are presented within other current liabilities on the consolidated balance sheets on a gross basis.

Third-party pharmacy receivables generally relate to amounts due from members' insurance companies for the amount above their co-pay, which is collected at the point-of-sale.

Amounts are recorded net of an allowance for doubtful accounts. Management determines the allowance for doubtful accounts based on historical experience and application of the specific identification method.

#### Vendor Receivables and Allowances

Periodic payments from vendors in the form of volume rebates or other purchase discounts that are evidenced by signed agreements are reflected in the carrying value of the inventory when earned or as the Company progresses towards earning the rebate or discount and as a component of merchandise costs as the merchandise is sold. Other consideration received from vendors is generally recorded as a reduction of merchandise costs upon completion of contractual milestones, terms of the related agreement, or by other systematic approach.

#### Merchandise Inventories

Merchandise inventories are valued at the lower of cost or market, as determined primarily by the retail inventory method, and are stated using the last-in, first-out (LIFO) method for substantially all U.S. merchandise inventories. Merchandise inventories for all foreign operations are primarily valued by the retail inventory method and are stated using the first-in, first-out (FIFO) method. The Company believes the LIFO method more fairly presents the results of operations by more closely matching current costs with current revenues. The Company records an adjustment each quarter, if necessary, for the expected annual effect of inflation, and these estimates are adjusted to actual results determined at year-end. At the end of 2008, due to overall net inflationary trends, merchandise inventories valued at LIFO were lower than the FIFO value, resulting in a \$32 charge to merchandise costs. During 2009, due to overall deflationary trends, the Company recorded a \$32 benefit to merchandise costs to adjust inventories valued at LIFO. At the end of 2009 and 2007, merchandise inventories valued at LIFO approximated FIFO after considering the lower of cost or market principle.

|                                     | 2009    | 2008    |
|-------------------------------------|---------|---------|
| Merchandise inventories consist of: |         |         |
| United States (primarily LIFO)      | \$4,080 | \$3,856 |
| Foreign (FIFO)                      | 1,325   | 1,183   |
| Total                               | \$5,405 | \$5,039 |

The Company provides for estimated inventory losses between physical inventory counts as a percentage of net sales, using estimates based on the Company's experience. The provision is adjusted periodically to reflect the results of the actual physical inventory counts, which generally occur in the second and fourth fiscal quarters of the fiscal year. Inventory cost, where appropriate, is reduced by estimates of vendor rebates when earned or as the Company progresses towards earning those rebates, provided that they are probable and reasonably estimable.

# **Property and Equipment**

Property and equipment are stated at cost. Depreciation and amortization expenses are computed using the straight-line method. Interest costs incurred on property during the construction period are capitalized. Estimated useful lives by major asset category are as follows:

|                                      | Years                     |
|--------------------------------------|---------------------------|
| Buildings                            | 5 - 50                    |
| Equipment and fixtures               |                           |
| Leasehold improvements               | Shorter of useful life or |
|                                      | lease term                |
| Land improvements                    | 15                        |
| Software acquisition and development | 3 - 6                     |

# Impairment of Long-Lived Assets

The Company periodically evaluates long-lived assets for impairment when management makes the decision to relocate or close a warehouse or when events or changes in circumstances occur that may indicate the carrying amount of the asset group, generally an individual warehouse, may not be fully recoverable. For asset groups to be held and used, including warehouses to be relocated, the carrying value of the asset group is recoverable when the estimated future undiscounted cash flows generated from the use and eventual disposition of the asset group exceed the group's net carrying value. In the event that the carrying value is not recoverable, an impairment loss would be recognized for the asset group to be held and used as the excess of the carrying amount over the respective fair value. For

asset groups classified as held for sale (disposal group), the carrying value is compared to the disposal group's fair value less costs to sell. The Company estimates fair value by obtaining market appraisals from third party brokers or other valuation techniques. In 2009 and 2008, the Company recorded impairment charges of \$11 and \$10, respectively. For 2009, the charge was primarily related to the closure of its two Costco Home locations in July 2009. For 2008, the charge was primarily related to a warehouse that was demolished, rebuilt, and reopened in early 2009. No impairment charge for long-lived assets was recorded in 2007.

#### Other Assets

Other assets consist of the following at the end of 2009 and 2008:

|  | 2009  | 2008  |
|--|-------|-------|
| Investment in Costco Mexico                        | \$319 | \$364 |
| Prepaid rents, lease costs, and long-term deposits | 170   | 167   |
| Cash surrender value of life insurance             | 73    | 91    |
| Goodwill, net                                      | 71    | 74    |
| Notes receivable                                   | 56    | 59    |
| Other  | 50    | 42    |
| Long-term investments                              | 3     | 68    |
| Other Assets                                       | \$742 | \$865 |

The Company's investments in Costco Mexico, a 50%-owned joint venture, and in other unconsolidated joint ventures that are less than majority owned are accounted for under the equity method. The equity in earnings of Costco Mexico is included in interest income and other in the accompanying consolidated statements of income, and for 2009, 2008 and 2007, was \$32, \$41, and \$33, respectively. The amount of retained earnings that represents undistributed earnings of Costco Mexico was \$266 and \$234 at the end of 2009 and 2008, respectively. The investments and equity in earnings of other unconsolidated joint ventures are not material. The Company did not make any capital contributions to its investment in Costco Mexico in 2009, 2008, or 2007.

The Company adjusts the carrying value of its life insurance contracts to the net cash surrender value at the end of each reporting period. The adjustment reflects changes in the net realizable value of the employee life insurance contracts based largely on changes in investment assets underlying the policies and is included in selling, general, and administrative expenses. The net realizable value of these contracts is largely based on changes in investment assets underlying the policies and subject to conditions generally affecting equity and debt markets. The adjustment to cash surrender value was a decrement of \$23 and \$10 in 2009 and 2008, respectively, and a benefit of \$6 in 2007. These amounts are reflected in other non-cash items, net, in cash flows from operations in the accompanying consolidated statements of cash flows.

Goodwill resulting from certain business combinations is reviewed for impairment in the fourth quarter of each fiscal year, or more frequently if circumstances dictate. No impairment of goodwill has been incurred to date.

Notes receivable generally represent amounts due from cities over a number of years representing incentive amounts granted to the Company when a new location was opened, or for the repayment of certain infrastructure initially paid for by the Company.

# Accounts Payable

The Company's banking system provides for the daily replenishment of major bank accounts as checks are presented. Accordingly, included in accounts payable at the end of 2009 and 2008 are \$611 and \$640, respectively, representing the excess of outstanding checks over cash on deposit at the banks on which the checks were drawn.

# Insurance/Self Insurance Liabilities

The Company uses a combination of insurance and self-insurance mechanisms, including a wholly-owned captive insurance entity and participation in a reinsurance program, to provide for potential liabilities for workers' compensation, general liability, property damage, director and officers' liability, vehicle liability and employee health care benefits. Liabilities associated with the risks that are retained by the Company 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. As of the end of 2009 and 2008, these insurance liabilities of \$500 and \$485, respectively, were included in accounts payable, accrued salaries and benefits, and other current liabilities on the consolidated balance sheets, classified based on their nature.

The Company's wholly-owned captive insurance subsidiary (the captive) received \$120, \$131, and \$140 in direct premiums during 2009, 2008, and 2007, respectively. These revenues are netted against the Company's premium costs in selling, general and administrative expenses, in the consolidated statements of income. The captive participates in a reinsurance program. The member agreements and practices of the reinsurance program limit any participating members' individual risk. Reinsurance premiums assumed and ceded were \$76, \$68, and \$68 during 2009, 2008, and 2007, respectively. Both revenues and costs are presented on a net basis in selling, general and administrative expenses in the consolidated statements of income. Income statement adjustments related to the reinsurance program are recognized as information is received. In the event the Company leaves the reinsurance program, the Company is not relieved of its primary obligation to the policyholders for activity prior to the termination of the agreement.

### Other Current Liabilities

Other current liabilities consist of the following at the end of 2009 and 2008:

|  | 2009    | 2008    |
|--|---------|---------|
| 2% Reward liability                        | \$ 456  | \$ 422  |
| Insurance related liabilities              | 241     | 238     |
| Cash card liability                        | 93      | 91      |
| Other current liabilities                  | 83      | 82      |
| Sales return reserve                       | 79      | 84      |
| Sales and vendor consideration liabilities | 68      | 79      |
| Deferred sales adjustment                  | 65      | 66      |
| Tax-related liabilities                    | 54      | 44      |
| Interest payable                           | 51      | 51      |
| Other Current Liabilities                  | \$1,190 | \$1,157 |

#### Derivatives

Effective November 24, 2008, the beginning of the Company's second quarter of 2009, the Company adopted the disclosure requirements of Statement of Financial Accounting Standards (SFAS) No. 161, "Disclosures about Derivative Instruments and Hedging Activities—an Amendment of FASB Statement No. 133" (SFAS 161). The Company follows SFAS No 133, "Accounting for Derivative Instruments and Hedging Activities (as amended)" (SFAS 133), in accounting for derivative and hedging activities.

The Company is exposed to foreign currency exchange-rate fluctuations in the normal course of its business, which the Company manages, in part, through the use of forward foreign exchange contracts, seeking to hedge the impact of fluctuations of foreign exchange on known future expenditures denominated in a foreign currency. The forward foreign exchange contracts are entered into by the Company primarily to hedge U.S. dollar merchandise inventory expenditures. Currently, these instruments do not qualify for derivative hedge accounting. The Company uses these instruments to mitigate risk and does not intend to engage in speculative transactions. The aggregate notional amount of forward foreign exchange contracts was \$183 and \$90 at the end of 2009 and 2008, respectively. These contracts do not contain any credit-risk-related contingent features.

The Company seeks to manage the counterparty risk associated with these forward foreign exchange contracts by limiting transactions to counterparties with which the Company has an established banking relationship. There can be no assurance, however, that this effectively mitigates counterparty risk. In addition, the contracts are limited to a time period of less than one year. See Note 3 for information on the fair value of these contracts.

At the end of 2009, the fair value of the Company's derivatives, which do not qualify for hedge accounting under SFAS 133, was as follows:

|                                       | Asset | Liability |
|---------------------------------------|-------|-----------|
| Forward foreign exchange contracts(1) | \$2   | \$4       |
| Total derivatives                     | \$2   | \$4       |

<sup>(1)</sup> The asset and the liability values are included in deferred income taxes and other current assets and other current liabilities, respectively, in the accompanying consolidated balance sheets.

The following table summarizes the amount of gain or (loss) recognized in interest income and other in the accompanying consolidated statements of income:

|                                    | 2009  | 2008 | 2007 |
|------------------------------------|-------|------|------|
| Forward foreign exchange contracts | \$(5) | \$6_ | \$—  |
| Total                              | \$(5) | \$6  | \$   |

The Company is exposed to risks due to fluctuations in energy prices, particularly electricity and natural gas, which it seeks to partially mitigate through the use of fixed-price contracts with counterparties for approximately 24% of its warehouses and other facilities in the U.S. and Canada. The Company also enters into variable-priced contracts for some purchases of natural gas and fuel for its gas stations on an index basis. These contracts qualify for treatment as "normal purchase or normal sales" under SFAS 133 and require no mark-to-market adjustment.

# Foreign Currency Translation

The functional currencies of the Company's international subsidiaries are the local currency of the country in which the subsidiary is located. Assets and liabilities recorded in foreign currencies, as well as the Company's investment in Costco Mexico, are translated at the exchange rate on the balance sheet date. Translation adjustments resulting from this process are charged or credited to accumulated other comprehensive income. Revenues and expenses of the Company's consolidated foreign operations are translated at average rates of exchange prevailing during the year. Gains and losses on foreign currency transactions are included in interest income and other and were not significant in 2009, 2008, or 2007.

# Revenue Recognition

The Company generally recognizes sales, net of estimated returns, at the time the member takes possession of merchandise or receives services. When the Company collects payments from customers prior to the transfer of ownership of merchandise or the performance of services, the amounts received are generally recorded as deferred revenue on the consolidated balance sheets until the sale or service is completed. The Company provides for estimated sales returns based on historical trends in merchandise returns. Amounts collected from members, which under common trade practices are referred to as sales taxes, are recorded on a net basis.

During 2007, in connection with changes to its consumer electronic returns policy, the Company developed more detailed operational data regarding member return patterns. The data indicated a longer timeframe over which returns are received than was previously estimated. Accordingly, during 2007 the Company increased the estimated sales returns reserve balance and recorded an adjustment to sales of \$452 and a pretax charge to income of \$94 for the related gross margin and disposition costs.

The Company evaluates whether it is appropriate to record the gross amount of merchandise sales and related costs or the net amount earned as commissions. Generally, when Costco is the primary obligor, is subject to inventory risk, has latitude in establishing prices and selecting suppliers, can influence product or service specifications, or has several but not all of these indicators, revenue is recorded on a gross basis. If the Company is not the primary obligor and does not possess other indicators of gross reporting as noted above, it records the net amounts as commissions earned, which is reflected in net sales.

Membership fee revenue represents annual membership fees paid by substantially all of the Company's members. The Company accounts for membership fee revenue on a deferred basis, whereby revenue is recognized ratably over the one-year membership period. In 2007, the Company performed a detailed analysis of the timing of recognition of membership fees based on each member's specific renewal date, as this methodology represented an improvement over the historical method, which was based on the period in which the fee was collected. This review resulted in a \$56 reduction to membership fee revenue in 2007 and a corresponding increase to deferred membership fees on the Company's consolidated balance sheet. This adjustment included both a change in method of applying an accounting principle to a preferable method and a correction for cumulative timing errors. The adjustment for the change in method and for the correction was recorded in full in the 2007 consolidated statement of income as the Company concluded the impact to the current and historical financial statements was not material.

As previously disclosed, effective with renewals occurring on and after March 1, 2009, the Company changed an element of its membership renewal policy. Memberships renewed within two months after expiration of the current membership year are extended for twelve months from the expiration date. (Under the previous policy, renewals within six months of the expiration date were extended for twelve

months from the expiration date.) Memberships renewed more than two months after such expiration date are extended for twelve months from the renewal date. Although this change will have the effect of deferring recognition of certain membership fees paid by late-renewing members, the effect is not expected to be material.

The Company's Executive members qualify for a 2% reward, which can be redeemed at Costco warehouses, up to a maximum of \$500 per year, on all qualified purchases made at Costco. The Company accounts for this 2% reward as a reduction in sales, with the related liability being classified within other current liabilities. The sales reduction and corresponding liability are computed after giving effect to the estimated impact of non-redemptions based on historical data. The reduction in sales was \$610, \$571, and \$488 in 2009, 2008, and 2007, respectively.

#### Merchandise Costs

Merchandise costs consist of the purchase price of inventory sold, inbound shipping charges and all costs related to the Company's depot operations, including freight from depots to selling warehouses, and are reduced by vendor consideration received. Merchandise costs also include salaries, benefits and depreciation on production equipment in certain fresh foods and ancillary departments.

# Selling, General and Administrative Expenses

Selling, general and administrative expenses consist primarily of salaries, benefits and workers' compensation costs for warehouse employees, other than fresh foods departments and certain ancillary businesses, as well as all regional and home office employees, including buying personnel. Selling, general and administrative expenses also include utilities, bank charges, rent and substantially all building and equipment depreciation, as well as other operating costs incurred to support warehouse operations.

# Marketing and Promotional Expenses

Costco's policy is generally to limit marketing and promotional expenses to new warehouse openings, occasional direct mail marketing to prospective new members and direct mail marketing programs to existing members promoting selected merchandise. Marketing and promotional costs are expensed as incurred and are included in selling, general and administrative, and preopening expenses in the accompanying consolidated statements of income.

# Stock-Based Compensation

Compensation expense for all stock-based awards granted is recognized using the straight-line method. The fair value of restricted stock units (RSUs) is calculated as the market value of the common stock on the measurement date less the present value of the expected dividends forgone during the vesting period. The fair value of stock options is measured using the Black-Scholes valuation model. While options and RSUs granted to employees generally vest over five years, all grants allow for either daily or quarterly vesting of the pro-rata number of stock-based awards that would vest on the next anniversary of the grant date in the event of retirement or voluntary termination. The historical experience rate of actual forfeitures has been minimal. As such, the Company does not reduce stock-based compensation for an estimate of forfeitures because the estimate is inconsequential in light of historical experience and considering the awards vest on either a daily or quarterly basis. The impact of actual forfeitures arising in the event of involuntary termination is recognized as actual forfeitures occur, which generally is infrequent. Stock-based compensation expense is included in merchandise costs and selling, general and administrative expenses on the consolidated statements of income. See Note 7 for additional information on the Company's stock-based compensation plans.

# Preopening Expenses

Preopening expenses related to new warehouses, major remodels and expansions, new regional offices and other startup operations are expensed as incurred.

# **Closing Costs**

Warehouse closing costs incurred relate principally to the Company's relocation of certain warehouses (that were not otherwise impaired) to larger and better-located facilities. The provisions for 2009, 2008, and 2007 included charges in the amounts indicated below:

|   | 2009 | 2008        | 2007 |
|---|------|-------------|------|
| Warehouse closing expenses                | \$ 9 | \$ 9        | \$16 |
| Impairment of long-lived operating assets | 8    | 10          | _    |
| Net gains on sale of real property        |      | (19)        | (2)  |
| Total                                     | \$17 | \$ <u> </u> | \$14 |

Warehouse closing expenses primarily relate to accelerated building depreciation based on the shortened useful life through the expected closing date and remaining lease obligations, net of estimated sublease income, for leased locations. At the end of both 2009 and 2008, the Company's reserve for warehouse closing costs was \$5 and primarily related to future lease obligations.

#### Fair Value of Financial Instruments

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

# Interest Income and Other

Interest income and other includes:

|                             | 2009  | 2008  | 2007  |
|-----------------------------|-------|-------|-------|
| Interest income             | \$ 27 | \$ 96 | \$128 |
| Earnings of affiliates      | 33    | 42    | 36    |
| Minority interest and other | (15)  | (5)   | 1     |
| Interest income and other   | \$ 45 | \$133 | \$165 |

# Other-Than-Temporary Impairment

The Company periodically evaluates unrealized losses in its investment securities for other-than-temporary impairment using both qualitative and quantitative criteria. In the event a security is deemed to be other-than-temporarily impaired, the Company recognizes the credit loss component in interest income and other in the consolidated financial statements. The Company generally only invests in debt securities.

#### Income Taxes

The Company accounts for income taxes using the asset and liability method. Under the asset and liability method, deferred tax assets and liabilities are recognized for the future tax consequences attributed to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and tax credits and loss carry-forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences and carry-forwards are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is established when necessary to reduce deferred tax assets to amounts expected to be realized.

The determination of the Company's 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 of uncertain tax positions are recorded in the Company's financial statements only after determining a more-likely-than-not probability that the uncertain tax positions will withstand challenge, if any, from tax authorities. When facts and circumstances change, the Company reassess these probabilities and records any changes in the consolidated financial statements as appropriate. See Note 9 for additional information.

# Net Income per Common Share

The computation of basic net income per share is based on the weighted average number of shares that were outstanding during the period. The computation of diluted net income per share is based on the weighted average number of shares used in the basic net income per share calculation plus the number of common shares that would be issued assuming exercise of all potentially dilutive common shares outstanding using the treasury stock method for shares subject to stock options and restricted stock units and the "if converted" method for the convertible note securities.

# Stock Repurchase Programs

Shares repurchased are retired, in accordance with the Washington Business Corporation Act. The par value of repurchased shares is deducted from common stock and the excess repurchase price over par value is deducted from additional paid-in capital and retained earnings. See Note 6 for additional information.

# Recent Accounting Pronouncements

In June 2009, the FASB issued SFAS No. 168, "The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles, a replacement of FASB Statement No. 162" ("SFAS 168"), which establishes the FASB Accounting Standards Codification as the source of authoritative U.S. generally accepted accounting principles (GAAP) (other than guidance issued by the SEC) to be used in the preparation of financial statements. SFAS 168 is effective prospectively for financial statements issued for interim and annual periods ending after September 15, 2009. The Company must adopt these new requirements in its first quarter of fiscal 2010, which will result in expanded disclosure.

In June 2009, the FASB issued SFAS No. 167, "Amendments to FASB Interpretation No. 46R" (SFAS 167), which revises the approach to determine the primary beneficiary of a variable interest entity (VIE) and requires companies to more frequently reassess whether they must consolidate a VIE. SFAS 167 applies prospectively starting with the first interim financial period of the annual reporting period beginning after November 15, 2009. The Company must adopt these new requirements in its first quarter of fiscal 2011. The Company does not expect the adoption of SFAS 167 to have a material impact on its consolidated financial statements.

In May 2009, the FASB issued SFAS No. 165, "Subsequent Events" (SFAS 165), which establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. SFAS 165 applies prospectively to both interim and annual financial periods ending after June 15, 2009. The Company adopted these new requirements in its fourth quarter of 2009. Adoption of this standard had no material impact on the Company's consolidated financial statements.

In April 2009, three FASB Staff Positions (FSP) were issued addressing fair value of financial instruments: FSP FAS 157-4, "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly" addresses determining fair values in inactive markets; FSP FAS 115-2, "Recognition and Presentation of Other-Than-Temporary Impairments" addresses other-than-temporary impairments for debt securities; and FSP FAS 107-1, "Disclosures about Fair Value of Financial Instruments" requires interim disclosures about fair value of financial instruments. The Company adopted these FSPs in its fourth quarter of 2009, with no material impact on the Company's consolidated financial statements.

In September 2006, the FASB issued SFAS No 157, "Fair Value Measurements" (SFAS 157), which establishes a framework for measuring fair value and requires expanded disclosures regarding fair value measurements. In February 2008, the FASB issued FSP FAS 157-2, "Effective Date of FASB Statement 157" (FSP 157-2), which allows for the deferral of the adoption date of SFAS 157 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis. The Company elected to defer the adoption of SFAS 157 for the assets and liabilities within the scope of FSP 157-2 until August 31, 2009, the beginning of its fiscal year 2010. In October 2008, the FASB issued FSP FAS 157-3, "Determining the Fair Value of a Financial Asset in a Market That Is Not Active" (FSP 157-3), which clarifies the application of SFAS 157 when the market for a financial asset is inactive. The adoption of SFAS 157 for those assets and liabilities not subject to the deferral permitted by FSP 157-2 did not have a material impact on the Company's financial position or results of operations and is summarized in Note 3. The Company does not expect the adoption of SFAS 157 for non-financial assets and liabilities to have a material impact on its consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements, an Amendment of Accounting Research Bulletin No 51" (SFAS 160). SFAS 160 establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, changes in a parent's ownership of a noncontrolling interest, calculation and disclosure of the consolidated net income attributable to the parent and the noncontrolling interest, changes in a parent's ownership interest while the parent retains its controlling financial interest and fair value measurement of any retained noncontrolling equity investment. SFAS 160 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Early adoption is prohibited. The Company must adopt these new requirements in its first quarter of fiscal 2010. SFAS 160 will change the accounting and reporting for minority interests, and require expanded disclosure.

In December 2007, the FASB issued SFAS No. 141R, "Business Combinations" (SFAS 141R), which establishes principles and requirements for the reporting entity in a business combination, including recognition and measurement in the financial statements of the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. SFAS 141R applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008, and interim periods within those fiscal years. The Company must adopt these new requirements in its first quarter of fiscal 2010.

Except as noted above, the Company is in the process of evaluating the impact that adoption of these standards will have on its future consolidated financial statements.

#### Note 2—Investments

The major categories of the Company's investments are as follows:

# Money market mutual funds:

The Company invests in money funds that seek to maintain a net asset value of a \$1.00, while limiting overall exposure to credit, market, and liquidity risks.

# U.S. government and agency securities:

These U.S. government secured debt instruments are publicly traded and valued. Losses in this category are primarily due to market liquidity and interest rate reductions.

# Corporate notes and bonds:

The Company evaluates its corporate debt securities based on a variety of factors including, but not limited to, the credit rating of the issuer. The vast majority of the Company's corporate debt securities are rated investment grade by the major rating agencies.

# Asset and mortgage-backed securities:

The vast majority of the Company's asset and mortgage-backed securities have investment grade credit ratings from the major rating agencies. These investments are collateralized by residential sub-prime credit, credit card receivables, commercial real estate, foreign mortgage receivables, and lease receivables. Estimates of fair value are based upon a variety of factors including, but not limited to, credit rating of the issuer, internal credit risk, interest rate variation, prepayment assumptions, and the potential for default.

# Certificates of deposit:

Certificate of deposits are short-term interest-bearing debt instruments issued by various financial institutions with which the Company has an established banking relationship. Those certificates of deposit issued by U.S. financial institutions are insured by the Federal Deposit Insurance Corporation.

The Company's investments at August 30, 2009 and August 31, 2008, were as follows:

|                            |            |                     |                      |                   | Balance Sheet<br>Classification |                 |
|----------------------------|------------|---------------------|----------------------|-------------------|---------------------------------|-----------------|
| 2009:                      | Cost Basis | Unrealized<br>Gains | Unrealized<br>Losses | Recorded<br>Basis | Short-term<br>Investments       | Other<br>Assets |
| Available-for-sale:        |            |                     |                      |                   |                                 |                 |
| Money market mutual funds  | \$ 13      | \$—                 | \$—                  | \$ 13             | \$ 13                           | \$              |
| U.S. government and agency |            |                     |                      |                   |                                 |                 |
| securities                 | 400        | 3                   | _                    | 403               | 403                             | _               |
| Corporate notes and bonds  | 49         | 1                   | (1)                  | 49                | 49                              | _               |
| Asset and mortgage-backed  |            |                     |                      |                   |                                 |                 |
| securities                 | 48         | 1                   |                      | 49                | 46                              | 3               |
| Total available-for-sale   | 510        | 5                   | (1)                  | 514               | 511                             | 3               |
| Held-to-maturity:          |            |                     | , ,                  |                   |                                 |                 |
| Certificates of deposit    | 59         | _                   | _                    | 59                | 59                              | _               |
| Total investments          | \$569      | \$ 5                | \$(1)                | \$573             | \$570                           | \$ 3            |

|                            |            |                     |                      |                   | Classification            |                 |  |
|----------------------------|------------|---------------------|----------------------|-------------------|---------------------------|-----------------|--|
| 2008:                      | Cost Basis | Unrealized<br>Gains | Unrealized<br>Losses | Recorded<br>Basis | Short-term<br>Investments | Other<br>Assets |  |
| Available-for-sale:        |            |                     |                      |                   |                           |                 |  |
| Money market mutual funds  | \$ 16      | \$                  | \$—                  | \$ 16             | \$ 16                     | \$—             |  |
| U.S. government and agency |            |                     |                      |                   |                           |                 |  |
| securities                 | 355        | 2                   | (1)                  | 356               | 356                       | _               |  |
| Corporate notes and bonds  | 115        | 1                   | (1)                  | 115               | 99                        | 16              |  |
| Asset and mortgage-backed  |            |                     |                      |                   |                           |                 |  |
| securities                 | 113        |                     | (2)                  | 111               | 84                        | 27              |  |
| Total available-for-sale   | 599        | 3                   | (4)                  | 598               | 555                       | 43              |  |
| Held-to-maturity:          |            |                     | , ,                  |                   |                           |                 |  |
| Certificates of deposit    | 1          |                     | _                    | 1                 | 1                         |                 |  |
| Enhanced money funds       | 125        |                     |                      | 125               | 100                       | 25              |  |
| Total held-to-maturity     | 126        | _                   | _                    | 126               | 101                       | 25              |  |
| Total investments          | \$725      | \$ 3                | \$ (4)               | \$724             | \$656                     | \$ 68           |  |
|                            |            |                     |                      |                   | -                         |                 |  |

**Balance Sheet** 

For available-for-sale securities, proceeds from sales were \$183, \$165, and \$496 in 2009, 2008, and 2007, respectively. Gross realized gains from sales were \$5, \$2, and \$1 in 2009, 2008 and 2007, respectively, and gross realized losses from sales were \$2 and \$1 in 2009 and 2007, respectively. In 2008, gross realized losses from sales were not significant.

The following tables present the length of time available-for-sale securities were in continuous unrealized loss positions, but were not deemed to be other-than-temporarily impaired:

|                                      | Less than                                | 12 Months  | Greater than or Equal to<br>12 Months    |            |
|--------------------------------------|--|------------|--|------------|
| August 30, 2009                      | Gross<br>Unrealized<br>Holding<br>Losses | Fair Value | Gross<br>Unrealized<br>Holding<br>Losses | Fair Value |
| U.S. government and agency           | \$—                                      | \$-        | \$—                                      | \$—        |
| Corporate notes and bonds            | _  | · —        | (1)                                      | 8          |
| Asset and mortgage-backed securities | _  | _          | _  | _          |
|                                      | \$                                       | \$-        | \$ (1)                                   | \$ 8       |
| August 31, 2008                      |  |            |  |            |
| U.S. government and agency           | \$ (1)                                   | \$187      | \$—                                      | \$—        |
| Corporate notes and bonds            | (1)                                      | 61         | _  | _          |
| Asset and mortgage-backed securities | (2)                                      | 58         | _  | _          |
|                                      | \$ (4)                                   | \$306      | \$                                       | \$         |

Gross unrealized holding losses of \$1, at August 30, 2009, for investments held greater than or equal to twelve months pertained to the Company's holdings in corporate notes and bonds. The unrealized loss on these securities largely reflects changes in interest rates and higher spreads driven by the challenging conditions in the credit markets. The \$1 of gross unrealized losses is attributable to the Company's holdings in eight individual securities from five issuers.

As the Company presently does not intend to sell its debt securities and believes that it is not more-likely-than-not that it will be required to sell the securities that are in an unrealized loss position before recovery of their amortized cost, the Company does not consider these securities to be other-than-temporarily impaired.

In 2008, one of the Company's enhanced money fund investments, Columbia Strategic Cash Portfolio Fund (Columbia), ceased accepting cash redemption requests and changed to a floating net asset value. In light of the restricted liquidity, the Company elected to receive a pro-rata allocation of the underlying securities in a separately managed account. The Company assessed the fair value of these securities through market quotations and review of current investment ratings, as available, coupled with an evaluation of the liquidation value of each investment and its current performance in meeting scheduled payments of principal and interest. During 2009 and 2008, the Company recognized \$12 and \$5, respectively, of other-than-temporary impairment losses related to these securities. The losses are included in interest income and other in the accompanying consolidated statements of income. At August 30, 2009 and August 31, 2008, the balance of the Columbia fund was \$27 and \$104, respectively, on the consolidated balance sheets.

In 2008, two other enhanced money fund investments, BlackRock Cash Strategies, LLC (BlackRock) and Merrill Lynch Capital Reserve Fund, LLC (Merrill Lynch), ceased accepting redemption requests and commenced liquidation. As of August 31, 2008, the balance of the BlackRock and Merrill Lynch funds was \$82 and \$43, respectively, on the consolidated balance sheets. During 2009, these funds were liquidated and the Company received the remaining balances of its investment.

During 2008, the Company reclassified \$371 of these three funds from cash and cash equivalents to short-term investments and other assets. At August 30, 2009, \$24 remained in short-term investments and \$3 remained in other assets on the consolidated balance sheets, reflecting the timing of the expected distributions. At August 31, 2008, \$161 was in short-term investments and \$68 in other assets on the consolidated balance sheets.

The markets relating to these investments remain uncertain, and there may be further declines in the value of these investments that may cause additional losses in future periods.

The maturities of available-for-sale and held-to-maturity securities at August 30, 2009 are as follows:

|                                       | Available-For-Sale |            | Held-To-Maturity |            |
|---------------------------------------|--------------------|------------|------------------|------------|
|                                       | Cost Basis         | Fair Value | Cost Basis       | Fair Value |
| Due in one year or less               | \$324              | \$325      | \$59             | \$59       |
| Due after one year through five years | 178                | 181        | _                | _          |
| Due after five years                  | 8                  | 8          |                  |            |
|                                       | \$510              | \$514      | \$59             | \$59       |

#### Note 3—Fair Value Measurement

On September 1, 2008, the Company adopted SFAS 157, as amended by FSP 157-1, FSP 157-2, and FSP 157-3 and effective May 11, 2009, the Company adopted FSP 157-4 (collectively referred to as SFAS 157), for all financial assets and liabilities that are recognized or disclosed at fair value in the consolidated financial statements on a recurring basis or on a nonrecurring basis during the reporting period. While the Company adopted the provisions of SFAS 157 for nonfinancial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a recurring basis, no such assets or liabilities existed at the balance sheet date. The Company, in accordance with FSP 157-2, delayed implementation of SFAS 157 for all nonfinancial assets and liabilities recognized or disclosed at fair value in the financial statements on a nonrecurring basis. Nonfinancial nonrecurring assets and liabilities included on the Company's consolidated balance sheets include items, such as goodwill and long lived assets, that are measured at fair value to test for and measure an impairment charge, when necessary.

SFAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the measurement date. SFAS 157 also establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs when measuring fair value. The standard describes three levels of inputs:

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

The following valuation techniques are used to measure fair value:

Level 1 primarily consists of financial instruments, such as money market mutual funds, whose value is based on quoted market prices, such as quoted net asset values published by the fund as supported in an active market, exchange-traded instruments and listed equities.

Level 2 includes assets and liabilities where quoted market prices are unobservable but observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities, could be obtained from data providers or pricing vendors. The Company's Level 2 assets and liabilities primarily include U.S. government and agency securities, investments in corporate notes and bonds, asset and mortgage-backed securities, and forward foreign exchange contracts. Valuation methodologies are based on "consensus pricing," using market prices from a variety of industry-standard independent data providers or pricing that considers various assumptions, including time value, yield curve, volatility factors, credit spreads, default rates, loss severity, current market and contractual prices for the underlying instruments or debt, broker and dealer quotes, as well as other relevant economic measures. All are observable in the market or can be derived principally from or corroborated by observable market data, for which the Company typically receives independent external valuation information.

Level 3 is comprised of significant unobservable inputs for valuations from the Company's independent data and a primary pricing vendor that are also supported by little, infrequent, or no market activity. Limited amounts of the Company's investments, which comprise the majority of securities in the Columbia fund that have not yet been sold or liquidated, are invested in asset and mortgage-backed securities and corporate notes and bonds that are classified as Level 3 based upon management's assessment of the available inputs. Management considers indicators of significant unobservable inputs such as the lengthening of maturities, later-than-scheduled payments, and any remaining individual securities that have otherwise matured, as indicators of Level 3. Assets and liabilities are considered Level 3 when their fair value inputs are unobservable, unavailable or management concludes that even though there may be some observable inputs, an item should be classified as a Level 3 based on other indicators of significant unobservable inputs, such as situations involving limited market activity, where determination of fair value requires significant judgment or estimation. The Company utilizes the services of a primary pricing vendor, which does not provide access to their proprietary valuation models, inputs and assumptions. While the Company is not provided access to proprietary models of the vendor, the Company reviewed and contrasts pricing received with other pricing sources to ensure accuracy of each asset class for which prices are provided. The Company's review also included an examination of the underlying inputs and assumptions for a sample of individual securities across asset classes, credit rating levels and various durations, a process that is continually performed for each reporting period. In addition, the pricing vendor has an established challenge process in place for all security valuations, which facilitates identification and resolution of potentially erroneous prices. The Company believes that the prices received from the primary pricing vendor are representative of exit prices in accordance with SFAS 157, as amended, and are classified appropriately in the SFAS 157 hierarchy.

During the third quarter of 2009, the Company considered continuing indicators of significant unobservable inputs, such as the lengthening of maturities, later-than-scheduled payments, and any securities that have defaulted, as Level 3 inputs for valuation. This resulted in a transfer of \$37 into Level 3 from Level 2. Transfers into and out of Level 3 from Level 2, where applicable, are reported using the fair value of the individual securities as of the beginning of the reporting period in which the transfer occurred. During the fourth quarter of 2009, the Company expanded its description of Level 3 input evaluation to address pricing elements of adopting FSP 157-4. This updated description did not change the current period's price evaluation as the pricing modeling used by the Company's primary pricing vendor during the previous quarter accounted for inputs in accordance with the newly adopted standard. At August 30, 2009, all of the Company's Level 3 investments of \$26, were comprised of individual securities in the Columbia fund and represent the majority of the balance of the fund at August 30, 2009.

# Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following table presents information about the Company's financial assets and financial liabilities that are measured at fair value on a recurring basis as of August 30, 2009, and indicates the fair value hierarchy of the valuation techniques utilized to determine such fair value:

| Level 1 | Level 2                          | Level 3                              |
|---------|----------------------------------|--------------------------------------|
|         |                                  |                                      |
| \$1,597 | \$ —                             | \$—                                  |
| _       | 403                              | _                                    |
| _       | 35                               | 14                                   |
| _       | 37                               | 12                                   |
| _       | 2                                | _                                    |
|         | (4)                              |                                      |
| \$1,597 | \$473                            | \$26                                 |
| -       | \$1,597<br>—<br>—<br>—<br>—<br>— | \$1,597 \$ — 403 — 35 — 37 — 2 — (4) |

<sup>(1)</sup> See Note 1 for additional information on derivative instruments.

The table below provides a summary of the changes in fair value, including net transfers, of all financial assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the year ended August 30, 2009:

|  | Investment<br>in corporate<br>notes and<br>bonds | n corporate mortgage-<br>notes and backed |       |
|--|--|---|-------|
| Balance, beginning of period   | \$ 12  | \$ 6                                      | \$ 18 |
| Total realized and unrealized gains (losses):  |  |   |       |
| Included in other comprehensive income   |  | 3   | 3     |
| Included in interest income and other  | (4)  | (6)                                       | (10)  |
| Purchases, issuances, and (settlements)  | (17)   | (23)                                      | (40)  |
| Net transfers in   | 23   | 32  | 55    |
| Balance, end of period   | \$ 14  | 12  | 26    |
| Change in unrealized gains (losses) included in interest income and other related to assets held as of August 30, 2009 | \$ (4)   | (4)                                       | (8)   |

# Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

As discussed in Note 2, the Company previously held enhanced money fund investments within the BlackRock and Merrill Lynch portfolios, which were classified as held-to-maturity. During 2009, these portfolios fully liquidated. The Company did not record any other-than-temporary impairment losses on these investments throughout the timeframe they were held.

Note 4—Debt

Bank Credit Facilities and Commercial Paper Programs (all amounts stated in U.S. dollars)

|                   |  |                    | Credit Line Usage at August 30, 2009 |   |                                   |                             |                     |                                |
|-------------------|--|--------------------|--------------------------------------|---|-----------------------------------|-----------------------------|---------------------|--------------------------------|
| Entity            | Credit Facility<br>Description                   | Expiration<br>Date | Total of all Credit Facilities       | Stand-by<br>LC &<br>Letter of<br>Guaranty | Commercial<br>Letter of<br>Credit | Short-<br>Term<br>Borrowing | Available<br>Credit | Applicable<br>Interest<br>Rate |
| U.S               | Uncommitted Stand By Letter of Credit            | N/A                | \$ 22                                | \$22                                      | \$—                               | \$                          | \$ —                | N/A                            |
| U.S               | Uncommitted<br>Commercial<br>Letter of<br>Credit | N/A                | 50                                   | _   | 20                                | _                           | 30                  | N/A                            |
| Australia(1)      | Guarantee<br>Line                                | N/A                | 8                                    | _   | _                                 | _                           | 8                   | N/A                            |
| Canada(1)         | Line   | March-10           | 28                                   | 18  | _                                 | _                           | 10                  | 1.76%                          |
| Japan(1)          | Credit   | February-10        | 37                                   | _   | _                                 | 8                           | 29                  | 0.64%                          |
| Japan(1)          | Bank<br>Guaranty                                 | March-10           | 11                                   | 11  | _                                 | _                           | _                   | N/A                            |
| Japan(1)          | Credit   | February-10        | 37                                   | _   | _                                 | 8                           | 29                  | 0.70%                          |
| Japan(2)          | Commercial<br>Letter of<br>Credit                | N/A                | 1                                    | _   | _                                 | _                           | 1                   | N/A                            |
| Korea(1)          | Multi-Purpose<br>Line                            | March-10           | 10                                   | 1   | _                                 | _                           | 9                   | 3.75%                          |
| Taiwan            | Multi-Purpose<br>Line                            | January-10         | 15                                   | 4   | _                                 | _                           | 11                  | 2.50%                          |
| Taiwan            | Multi-Purpose<br>Line                            | July-10            | 15                                   | 3   | _                                 | _                           | 12                  | 2.59%                          |
| United Kingdom    | Credit   | February-10        | 66                                   | _   | _                                 | _                           | 66                  | 0.82%                          |
| United Kingdom    | Uncommitted<br>Money<br>Market Line              | N/A                | 33                                   | _   | _                                 | _                           | 33                  | 3.05%                          |
| United Kingdom    | Uncommitted<br>Overdraft<br>Line                 | N/A                | 49                                   | _   | _                                 | _                           | 49                  | 1.50%                          |
| United Kingdom(2) |  | N/A                | 3                                    | 3   | _                                 | _                           | _                   | N/A                            |
| United Kingdom    |  | N/A                | 3                                    |   | 1                                 | _                           | 2                   | N/A                            |
|                   | TOTAL  |                    | \$388                                | \$62                                      | \$21                              | \$16                        | \$289               |                                |

<sup>(1)</sup> The U.S. parent company, Costco Wholesale Corporation, guarantees this entity's credit facility.

<sup>(2)</sup> The letter of guarantee is fully cash-collateralized by the subsidiary.

|                   |  |                    |                                |   | recuge at rang                    | ,                          |                     |                                |
|-------------------|--|--------------------|--------------------------------|---|-----------------------------------|----------------------------|---------------------|--------------------------------|
| Entity            | Credit Facility<br>Description                   | Expiration<br>Date | Total of all Credit Facilities | Stand-by<br>LC &<br>Letter of<br>Guaranty | Commercial<br>Letter of<br>Credit | Short<br>Term<br>Borrowing | Available<br>Credit | Applicable<br>Interest<br>Rate |
| U.S               | Uncommitted<br>Stand By<br>Letter of<br>Credit   | N/A                | \$ 25                          | \$25                                      | \$—                               | \$ —                       | \$ —                | N/A                            |
| U.S               | Uncommitted<br>Commercial<br>Letter of<br>Credit | N/A                | 160                            | _   | 45                                | _                          | 115                 | N/A                            |
| Australia(1)      | Guarantee<br>Line                                | N/A                | 9                              | 3   | _                                 | _                          | 6                   | N/A                            |
| Canada(1, 3)      | Multi-<br>Purpose<br>Line                        | March-09           | 142                            | 20  | _                                 | 85                         | 37                  | 3.43%                          |
| Japan(1)          | Revolving<br>Credit                              | February-09        | 32                             | _   | _                                 | 4                          | 28                  | 1.00%                          |
| Japan(1)          | Bank<br>Guaranty                                 | February-09        | 9                              | 9   | _                                 | _                          | _                   | N/A                            |
| Japan(1)          | Revolving<br>Credit                              | February-09        | 32                             | _   | _                                 | 14                         | 18                  | 1.04%                          |
| Korea(1)          | Multi-<br>Purpose<br>Line                        | March-09           | 11                             | 1   | 1                                 | _                          | 9                   | 6.53%                          |
| Taiwan            | Multi-<br>Purpose<br>Line                        | January-09         | 16                             | 5   | _                                 | _                          | 11                  | 4.50%                          |
| Taiwan            | Multi-<br>Purpose<br>Line                        | July-09            | 16                             | 2   | _                                 | _                          | 14                  | 4.59%                          |
| United Kingdom    | Revolving<br>Credit                              | February-10        | 73                             | _   | _                                 | _                          | 73                  | 5.67%                          |
| United Kingdom    | Uncommitted<br>Money<br>Market                   | May-09             | 37                             | _   | _                                 | 31                         | 6                   | 5.36%                          |
| United Kingdom    | Overdraft<br>Line                                | May-09             | 64                             | _   | _                                 | _                          | 64                  | 6.00%                          |
| United Kingdom(2) | Letter of<br>Guarantee                           | N/A                | 4                              | 4   | _                                 | _                          | _                   | N/A                            |
| United Kingdom    |  | N/A                | 3                              | _   | 1                                 | _                          | 2                   | N/A                            |
|                   | TOTAL  |                    | \$633                          | \$69                                      | \$47                              | \$134                      | \$383               |                                |
|                   |  |                    |                                |   |                                   |                            |                     |                                |

Credit Line Usage at August 31, 2008

Note: The Company has letter of credit facilities (for commercial and standby letters of credit) totaling \$116 and \$239 as of August 30, 2009 and August 31, 2008, respectively. The outstanding commitments under these facilities at August 30, 2009 and August 31, 2008 totaled \$83 and \$116, respectively, including \$62 and \$69, respectively, in standby letters of credit. For those entities with multi-purpose lines, any issuance of either letters of credit (standby and/or commercial) or short-term borrowings will result in a corresponding decrease in available credit.

<sup>(1)</sup> This entity's credit facility is guaranteed by the U.S. parent company, Costco Wholesale Corporation.

<sup>(2)</sup> The letter of guarantee is fully cash-collateralized by the United Kingdom subsidiary.

<sup>(3)</sup> The amount shown for short-term borrowings under this facility is net of a note issue discount, which is excluded from the available credit amount.

# **Short-Term Borrowings**

The weighted average borrowings, maximum borrowings, and weighted average interest rate under all short-term borrowing arrangements were as follows for 2009 and 2008:

| Category of Aggregate<br>Short-term Borrowings | Maximum Amount<br>Outstanding<br>During the Fiscal Year | Average Amount<br>Outstanding<br>During the Fiscal Year | Weighted Average<br>Interest Rate<br>During the Fiscal Year |
|--|---|---|---|
| Year ended August 30, 2009                     |   |   |   |
| Bank borrowings:                               |   |   |   |
| Canada   | \$ 90   | \$64  | 2.80%   |
| United Kingdom                                 | 31  | 23  | 1.72  |
| Japan  | 29  | 22  | 0.93  |
| Bank overdraft facility:                       |   |   |   |
| United Kingdom                                 | 20  | 4   | 1.64  |
| Other:   |   |   |   |
| United Kingdom Money Market Line               |   |   |   |
| Borrowing                                      | 31  | 13  | 4.47  |
| Year ended August 31, 2008                     |   |   |   |
| Bank borrowings:                               |   |   |   |
| Canada   | \$175   | \$82  | 3.79%   |
| United Kingdom                                 | 32  | 22  | 5.87  |
| Japan  | 22  | 15  | 1.07  |
| Bank overdraft facility:                       |   |   |   |
| United Kingdom                                 | 8   | 2   | 6.26  |
| Other:   |   |   |   |
| United Kingdom Money Market Line               |   |   |   |
| Borrowing                                      | 38  | 16  | 5.56  |

At August 30, 2009, the Company was in compliance with all restrictive covenants of its short-term borrowings.

# Long-Term Debt

Long-term debt at August 30, 2009 and August 31, 2008 consisted of the following:

|  | 2009    | 2008    |
|--|---------|---------|
| 5.5% Senior Notes due March 2017                       | \$1,096 | \$1,095 |
| 5.3% Senior Notes due March 2012                       | 899     | 898     |
| 2.695% Promissory notes due October 2017               | 69      | 60      |
| 0.92% Promissory notes due April 2010                  | 43      | 37      |
| 3.5% Zero Coupon convertible subordinated notes due    |         |         |
| August 2017  | 32      | 49      |
| 0.35% over Yen Tibor (6-month) Term Loan due June 2018 | 32      | 28      |
| 0.88% Promissory notes due November 2009               | 32      | 28      |
| Capital lease obligations and other                    | 84      | 17      |
| Total long-term debt                                   | 2,287   | 2,212   |
| Less current portion                                   | 81      | 6       |
| Long-term debt, excluding current portion              | \$2,206 | \$2,206 |

In July 2009, the Company entered into a capital lease for a new warehouse location and recorded a liability in the amount of \$72, representing the net present value of \$150 in aggregate future minimum

lease payments at an imputed interest rate of 5.4%. This lease expires and becomes subject to a renewal clause in 2040. As of August 30, 2009, \$71 is included in long-term debt and \$1 in the current portion of long-term debt on the consolidated balance sheets. The Company has other minor capital lease obligations that amounted to \$5 at the end of 2009 and 2008.

In June 2008, the Company's wholly-owned Japanese subsidiary entered into a ten-year term loan in the amount of \$32, with a variable rate of interest of Yen TIBOR (6-month) plus a 0.35% margin (0.95% and 1.24% at August 30, 2009 and August 31, 2008, respectively) on the outstanding balance. The net proceeds were used to repay the 1.187% Promissory Notes due in July 2008 and for general corporate purposes. Interest is payable semi-annually in December and June and principal is due in June 2018.

In October 2007, the Company's wholly-owned Japanese subsidiary issued promissory notes through a private placement in the amount of \$69, bearing interest at 2.695%. Interest is payable semi-annually, and principal is due in October 2017. The proceeds were used to repay the 2.07% Promissory Notes in October 2007 and for general corporate purposes.

In February 2007, the Company issued \$900 of 5.3% Senior Notes due March 15, 2012 (2012 Notes) at a discount of \$2 and \$1,100 of 5.5% Senior Notes due March 15, 2017 (2017 Notes) at a discount of \$6 (together the 2007 Senior Notes). Interest on the 2007 Senior Notes is payable semi-annually on March 15 and September 15 of each year and the net proceeds were used, in part, to repay the 5.5% 2002 Senior Notes due in March 2007. The \$8 discount and \$2 issuance costs associated with the Senior Notes are being amortized to interest expense over the terms of those notes. The Company, at its option, may redeem the 2007 Senior Notes at any time, in whole or in part, at a redemption price plus accrued interest. The redemption price is equal to the greater of 100% of the principal amount of the 2007 Senior Notes to be redeemed, or the sum of the present values of the remaining scheduled payments of principal and interest to maturity. Additionally, the Company will be required to make an offer to purchase the 2007 Senior Notes at a price of 101% of the principal amount plus accrued and unpaid interest to the date of repurchase, upon certain events as defined by the terms of the 2007 Senior Notes.

In April 2003, the Company's wholly-owned Japanese subsidiary issued promissory notes bearing interest at 0.92% in the amount of \$43, through a private placement. Interest is payable semi-annually and principal is due in April 2010. In November 2002, the Company's wholly-owned Japanese subsidiary issued promissory notes bearing interest at 0.88% in the aggregate amount of \$32, through a private placement. Interest is payable semi-annually and principal is due in November 2009. The Company guarantees all of the promissory notes issued by its wholly-owned Japanese subsidiary.

In August 1997, the Company sold \$900 principal amount at maturity 3.5% Zero Coupon Convertible Subordinated Notes (Zero Coupon Notes) due in August 2017. The Zero Coupon Notes were priced with a yield to maturity of 3.5%, resulting in gross proceeds to the Company of \$450. The current Zero Coupon Notes outstanding are convertible into a maximum of 961,000 shares of Costco Common Stock shares at an initial conversion price of \$22.71. Holders of the Zero Coupon Notes may require the Company to purchase the Zero Coupon Notes (at the discounted issue price plus accrued interest to date of purchase) in August 2012. The Company, at its option, may redeem the Zero Coupon Notes (at the discounted issue price plus accrued interest to date of redemption) any time after August 2002. As of August 30, 2009, \$858 in principal amount of the Zero Coupon Notes had been converted by note holders to shares of Costco Common Stock, of which \$25, \$1, and \$61 in principal were converted in 2009, 2008, and 2007, respectively, or \$19 and \$42 in 2009 and 2007, respectively, after factoring in the related debt discount. In 2008, the conversion of principle for Zero Coupon Notes after factoring the related debt discount was not significant.

At August 30, 2009, the fair value of the Zero Coupon Notes, based on market quotes, was approximately \$44, the fair value of the 2012 Notes and 2017 Notes was \$973 and \$1,213, respectively, and the fair value of other long-term debt approximated its carrying value. The fair value of the Zero Coupon Notes and the 2007 Senior Notes are based on quoted market prices of similar types of borrowing arrangements or the Company's current incremental borrowing rate, if applicable.

Maturities of long-term debt during the next five fiscal years and thereafter are as follows:

| 2010       | \$    | 81  |
|------------|-------|-----|
| 2011       |       | 2   |
| 2012       | 9     | 00  |
| 2013       |       | 1   |
| 2014       |       |     |
| Thereafter | 1,3   | 01  |
| Total      | \$2,2 | .87 |

#### Note 5—Leases

The Company leases land and/or buildings at 112 of the 527 warehouses open at August 30, 2009, and certain other office and distribution facilities primarily under operating leases. These leases expire at various dates through 2049, with the exception of one lease in the Company's United Kingdom subsidiary, which expires in 2151. These leases generally contain one or more of the following options which the Company can exercise at the end of the initial lease term: (a) renewal of the lease for a defined number of years at the then-fair market rental rate or rate stipulated in the lease agreement; (b) purchase of the property at the then-fair market value; or (c) right of first refusal in the event of a third party purchase offer.

The Company accounts for its lease expense with free rent periods and step-rent provisions on a straight-line basis over the original term of the lease, from the date the Company has control of the property. Certain leases provide for periodic rental increases based on the price indices, and some of the leases provide for rents based on the greater of minimum guaranteed amounts or sales volume. Contingent rents have not been material. Certain leases may require the Company to incur costs to return leased property to its original condition, such as the removal of gas tanks. The Company has recorded the estimated asset retirement obligation associated with these leases, which amounted to \$24 at the end of 2009.

Aggregate rental expense for 2009, 2008, and 2007 was \$177, \$167, and \$143, respectively.

The Company has sub-leases related to certain of its operating lease agreements. During 2009, 2008 and 2007, the Company recognized sub-lease income of \$10, \$10, and \$9, respectively, which is included in interest income and other in the consolidated statements of income.

Future minimum payments, net of sub-lease income of \$163 for all years combined, during the next five fiscal years and thereafter under non-cancelable operating leases with terms of at least one year, at August 30, 2009, were as follows:

| 2010                   | \$  | 145   |
|------------------------|-----|-------|
| 2011                   |     | 139   |
| 2012                   |     | 127   |
| 2013                   |     | 126   |
| 2014                   |     |       |
| Thereafter             | 1   | ,351  |
| Total minimum payments | \$2 | 2,009 |

# Note 6—Stockholders' Equity

#### Dividends

In 2009, the Company paid quarterly cash dividends totaling \$0.68 per share. In 2008 and 2007, the Company paid quarterly cash dividends totaling \$0.61 and \$0.55 per share, respectively. The Company's current quarterly dividend rate is \$0.18 per share or \$0.72 per share on an annualized basis.

Payment of future dividends is subject to declaration by the Board of Directors. Factors considered in determining the size of the dividends are profitability and expected capital needs of the Company. The Company presently expects to continue to pay dividends on a quarterly basis.

# Stock Repurchase Programs

The Company's stock repurchase activity during 2009, 2008, and 2007 is summarized in the following table:

|      | Shares<br>Repurchased<br>(000's) | Average<br>Price per<br>Share | Total Cost |
|------|----------------------------------|-------------------------------|------------|
| 2009 | 895                              | \$63.84                       | \$ 57      |
| 2008 | 13,812                           | 64.22                         | 887        |
| 2007 | 36,390                           | 54.39                         | 1,979      |

These amounts differ from the stock repurchase balances in the consolidated statements of cash flows to the extent that repurchases had not settled at the end of the fiscal year. Purchases are made from time-to-time as conditions warrant in the open market or in block purchases, and pursuant to share repurchase plans under SEC Rule 10b5-1. Repurchased shares are retired.

Amounts remaining under stock repurchase authorizations of the Board of Directors at the end of 2009 are detailed below:

| Date Authorized                          | Amount<br>Authorized | Amount<br>Repurchased | Amount Remaining |
|--|----------------------|-----------------------|------------------|
| Prior to September 2007                  | \$4,500              | \$4,500               | \$ —             |
| September 2007 (expires in August 2010)  | 300                  | 298                   | 2                |
| November 2007 (expires in November 2010) | 1,000                | _                     | 1,000            |
| July 2008 (expires in July 2011)         | 1,000                |                       | 1,000            |
| Total                                    | \$6,800              | \$4,798               | \$2,002          |

### Comprehensive Income

Comprehensive income includes net income plus certain other items that are recorded directly to stockholders' equity. Accumulated other comprehensive income reported on the Company's consolidated balance sheets consists of foreign currency translation adjustments and unrealized gains and losses on short-term investments and their related tax effects.

The following table shows the components of comprehensive income, net of related tax effects:

|   | 2009        | 2008        | 2007        |
|---|-------------|-------------|-------------|
| Unrealized gain on short-term investments             | \$ 5<br>(2) | \$ <u> </u> | \$ 6<br>(2) |
| Unrealized gain on short term investments, net of tax | 3           |             | 4           |
| Foreign currency translation adjustment               | (185)       | (89)        | 93          |
| to repatriation                                       |             | 4           | (4)         |
| Other comprehensive (loss) income adjustments, net    | (182)       | (85)        | 93          |
| Net income  | 1,086       | 1,283       | 1,083       |
| Total comprehensive income                            | \$ 904      | \$1,198     | \$1,176     |

The components of accumulated other comprehensive income, net of tax, were as follows:

|   | 2009  | 2008  |
|---|-------|-------|
| Unrealized gains on short-term investments        | \$ 3  | \$ —  |
| Foreign currency translation adjustment and other | 101   | 286   |
| Accumulated other comprehensive income            | \$104 | \$286 |

### **Note 7—Stock-Based Compensation Plans**

Through the first quarter of fiscal 2006, the Company granted stock options under the Amended and Restated 2002 Stock Incentive Plan (Second Restated 2002 Plan) and predecessor plans, and since the fourth quarter of fiscal 2006, the Company has granted RSUs in lieu of stock options under the Second Restated 2002 Plan. In the second quarter of 2008, the Second Restated 2002 Plan was amended following shareholder approval and is now referred to as the Third Restated 2002 Plan. The Third Restated 2002 Plan authorized the issuance of an additional eight million shares of common stock for future grants in addition to grants previously authorized. The Third Restated 2002 Plan was amended by the Board of Directors in July 2008 (Fourth Restated 2002 Plan). Under the Fourth Restated 2002 Plan, prospective grants of RSUs are subject, upon certain terminations of employment, to quarterly, as opposed to daily vesting. Previously awarded RSU grants continue to involve daily vesting upon certain terminations of employment. Additionally, employees who attain certain years of service with the Company will receive shares under accelerated vesting provisions on the annual vesting date rather than upon qualified retirement. The first grant impacted by these amendments occurred in the first quarter of 2009. Each share issued in respect of stock bonuses or stock units is counted as 1.75 shares toward the limit of shares made available under the Fourth Restated 2002 Plan. The Company issues new shares of common stock upon exercise of stock options and vesting of RSUs.

## Summary of Stock Option Activity

The following table summarizes stock option transactions during 2009:

|                                   | Shares<br>(in 000's) | Weighted-<br>Average<br>Exercise<br>Price | Weighted-<br>Average<br>Remaining<br>Contractual<br>Term<br>(in Years) | Aggregate<br>Intrinsic<br>Value(1) |
|-----------------------------------|----------------------|---|--|------------------------------------|
| Outstanding at the end of 2008    | 21,394               | \$40.04                                   |  |                                    |
| Granted                           | (2,539)              | 39.05                                     |  |                                    |
| Forfeited or expired              | (113)                | 40.77                                     |  |                                    |
| Outstanding at the end of 2009(2) | 18,742               | \$40.17                                   | 3.95   | <u>\$218</u>                       |
| Exercisable at the end of 2009    | 16,588               | \$39.62                                   | 3.73   | \$202                              |
|                                   |                      |   |  |                                    |

<sup>(1)</sup> The difference between the original exercise price and market value of common stock at August 30, 2009.

The following is a summary of stock options outstanding at the end of 2009 (number of options in thousands):

|                 | Op     | Options Outstanding                                     |  |        | cercisable                                |
|-----------------|--------|---|--|--------|---|
| Range of Prices | Number | Weighted<br>Average<br>Remaining<br>Contractual<br>Life | Weighted<br>Average<br>Exercise<br>Price | Number | Weighted-<br>Average<br>Exercise<br>Price |
| \$30.41–\$37.35 | 7,498  | 3.60  | \$35.16                                  | 7,498  | \$35.16                                   |
| \$37.44–\$43.00 | 3,377  | 1.96  | 40.45                                    | 3,377  | 40.45                                     |
| \$43.79–\$43.79 | 5,953  | 5.59  | 43.79                                    | 4,295  | 43.79                                     |
| \$45.99–\$52.50 | 1,914  | 3.72  | 48.01                                    | 1,418  | 48.63                                     |
|                 | 18,742 | 3.95  | \$40.17                                  | 16,588 | \$39.62                                   |

At the end of 2008 and 2007, there were 15,735 and 19,283 options exercisable at weighted average exercise prices of \$39.14 and \$38.35, respectively.

The tax benefits realized and intrinsic value related to total stock options exercised during 2009, 2008 and 2007 are provided in the following table:

|   | 2009 | 2008  | 2007  |
|---|------|-------|-------|
| Actual tax benefit realized for stock options exercised | \$10 | \$ 86 | \$ 66 |
| Intrinsic value of stock options exercised(1)           | \$27 | \$262 | \$213 |

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

<sup>(2)</sup> Stock options generally vest over five years and have a ten-year term.

## U.S. Attorney's Office Investigation on Certain Stock Options

As previously disclosed, in March 2007, the Company was informed by the U.S. Attorney's Office in the Western District of Washington that the office was conducting an investigation of the Company's past stock option granting practices to determine whether there had been any violations of federal law. As part of this investigation, the U.S. Attorney's Office served a grand jury subpoena on the Company, seeking documents and information relating to its historic stock option grants. On February 12, 2009, the U.S. Attorney's Office publicly announced that it had closed its investigation.

# Employee Tax Consequences on Certain Stock Options

As previously disclosed, in 2006, a special committee of independent directors was formed to determine whether the stated grant dates of stock options were supported by the Company's books and records. In connection with this review and guidance issued by the U.S. Internal Revenue Service in 2006, the Compensation Committee of the Board of Directors approved a program intended to protect approximately 1,000 Company employees who are United States taxpayers from certain adverse tax consequences resulting from their options having been granted originally at prices lower than the market value. The program involved increasing the exercise prices on certain stock options granted from 2000 to 2003 and, in turn, the Company making payments to employees in an amount approximately equal to the increase in the exercise price. In 2007, as a result of this program, the Company made cash payments totaling \$19 to approximately 1,000 employees, which resulted in a pre-tax stock compensation charge of \$8 ("incremental fair value"). The difference between the cash payment and the incremental fair value of \$11 was recognized as a reduction to additional paid-in capital, as it represented a partial cash settlement of the original award because no future service was required to earn the cash payment.

Also connected with this review, the Company is examining alternatives to mitigate the potential adverse tax consequences associated with effected unexercised options held by Canadian employees that were the subject of an accounting adjustment in fiscal 2006. During 2009 and 2008, the Company made payments of approximately \$7 and \$38, respectively, to employees in Canada related to options exercised in calendar years 2004 through the end of calendar year 2008. The related liability as of the end of 2009 and 2008 was \$2 and \$9, respectively.

### Summary of Restricted Stock Unit Activity

RSUs granted to employees and to non-employee directors generally vest over five years and three years, respectively; however, the Company provides for accelerated vesting upon qualified retirement for recipients that have attained certain years of service with the Company. Recipients are not entitled to vote or receive dividends on unvested shares. At the end of 2009, 5,343,000 RSUs were available to be granted to eligible employees and directors under the Fourth Restated 2002 Plan.

The following awards were outstanding at the end of 2009:

- 7,828,000 shares of time-based RSUs in which the restrictions lapse upon the achievement of continued employment over a specified period of time; and
- 703,000 performance RSUs, of which 305,000 will be formally granted to certain executive
  officers of the Company upon the official certification of the attainment of specified
  performance targets for 2009. Once formally granted, the restrictions lapse upon achievement
  of continued employment over a specified period of time.

The following table summarizes RSU transactions during 2009:

|                               | Number of<br>Units<br>(in 000's) | Weighted-Average<br>Grant Date<br>Fair Value |
|-------------------------------|----------------------------------|--|
| Non-vested at the end of 2008 | 6,705                            | \$56.97                                      |
| Granted                       | 3,691                            | 50.85  |
| Vested                        | (1,722)                          | 55.69  |
| Forfeited                     | (143)                            | 55.64  |
| Non-vested at the end of 2009 | 8,531                            | \$54.60                                      |

### Summary of Stock-Based Compensation

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

|  | 2009         | 2008         | 2007  |
|--|--------------|--------------|-------|
| Restricted stock units   | \$132        | \$ 97        | \$ 52 |
| Stock options  | 49           | 69           | 83    |
| Incremental expense related to modification of certain stock options |              |              | 8     |
| Total stock-based compensation expense before income taxes           | 181          | 166          | 143   |
| Income tax benefit   | (60)         | (55)         | (47)  |
| Total stock-based compensation expense, net of income tax            | <u>\$121</u> | <u>\$111</u> | \$ 96 |

The remaining unrecognized compensation cost related to non-vested RSUs at August 30, 2009, was \$345, and the weighed-average period of time over which this cost will be recognized is 3.3 years. The remaining unrecognized compensation cost related to unvested stock options at August 30, 2009, was \$20, and the weighted-average period of time over which this cost will be recognized is 0.6 years.

### **Note 8—Retirement Plans**

The Company has a 401(k) Retirement Plan that is available to all U.S. employees who have completed 90 days of employment. For all U.S. employees, with the exception of California union employees, the plan allows pre-tax deferrals against which the Company matches 50% of the first one thousand dollars of employee contributions. In addition, the Company provides each eligible participant an annual contribution based on salary and years of service.

California union employees participate in a defined benefit plan sponsored by their union. The Company makes contributions based upon its union agreement. For all the California union employees, the Company-sponsored 401(k) plan currently allows pre-tax deferrals against which the Company matches 50% of the first five hundred dollars of employee contributions. In addition, the Company will provide each eligible participant a contribution based on hours worked and years of service.

The Company has a defined contribution plan for Canadian and United Kingdom employees and contributes a percentage of each employee's salary. Certain other foreign operations have defined benefit and contribution plans that are not significant. Amounts expensed under all plans were \$287, \$272, and \$239 for 2009, 2008, and 2007, respectively.

#### **Note 9—Income Taxes**

Effective September 3, 2007, the Company adopted FIN 48, which clarified the accounting for uncertainty in income taxes recognized in financial statements. FIN 48 also prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition.

The cumulative effect of the initial adoption of FIN 48 was an increase of \$6 to the Company's liability for uncertain tax positions. The impact of this adjustment was to decrease the beginning balance of retained earnings and to increase the Company's liability for uncertain tax positions and related interest by a corresponding amount.

Upon adoption of FIN 48, the Company had approximately \$103 of gross unrecognized tax benefits. A reconciliation of the beginning and ending amount of gross unrecognized tax benefits for 2009 and 2008 is as follows:

|   | 2009  | 2008  |
|---|-------|-------|
| Gross unrecognized tax benefit at beginning of year | \$ 98 | \$103 |
| Gross increases—current year tax positions          | 9     | 7     |
| Gross increases—tax positions in prior years        | 6     | 13    |
| Gross decreases—tax positions in prior year         | (2)   | (11)  |
| Settlements   | (31)  | (12)  |
| Lapse of statute of limitations                     |       | (2)   |
| Gross unrecognized tax benefit at end of year       | \$ 80 | \$ 98 |
|   |       |       |

Included in the balance at August 30, 2009, are \$50 of tax positions for which the ultimate deductibility is highly certain but for which there is uncertainty about the timing of such deductibility. Because of the impact of deferred tax accounting, other than interest and penalties, the disallowance of these tax positions would not affect the annual effective tax rate but would accelerate the payment of cash to the taxing authority to an earlier period.

The total amount of such unrecognized tax benefits that, if recognized, would favorably affect the effective income tax rate in future periods is \$20 and \$35 at August 30, 2009 and August 31, 2008, respectively.

Accrued interest and penalties related to income tax matters are classified as a component of income tax expense, which is consistent with the classification prior to the adoption of FIN 48. During the year, the Company recognized \$4 of interest expense and penalties. Accrued interest and penalties are \$20 and \$24 at August 30, 2009 and August 31, 2008, respectively.

The Company is currently under audit by several taxing jurisdictions in the United States and in several foreign countries. Some audits may conclude in the next 12 months and the unrecognized tax benefits we have recorded in relation to the audits may differ from actual settlement amounts. It is not possible to estimate the effect, if any, of any amount of such change during the next 12 months to previously recorded uncertain tax positions in connection with the audits. The Company does not anticipate that there will be a material increase or decrease in the total amount of unrecognized tax benefits in the next twelve months.

The Company files income tax returns in the United States, various state and local jurisdictions, in Canada and in several other foreign jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state or local examination for years before fiscal 2004. The Company is currently subject to examination in Canada for fiscal years 2002 to present and in California for fiscal years 2004 to present. No other examinations are believed to be material.

Income before income taxes is comprised of the following:

|                                  | 2009    | 2008    | 2007    |
|----------------------------------|---------|---------|---------|
| Domestic (including Puerto Rico) | \$1,426 | \$1,542 | \$1,374 |
| Foreign                          | 288     | 457     | 336     |
| Total                            | \$1,714 | \$1,999 | \$1,710 |

The provisions for income taxes for 2009, 2008, and 2007 are as follows:

|                                  | 2009   | 2008   | 2007   |
|----------------------------------|--------|--------|--------|
| Federal:                         |        |        |        |
| Current                          | \$396  | \$470  | \$520  |
| Deferred                         | 67     | 35     | (74)   |
| Total federal                    | 463    | 505    | 446    |
| State:                           |        |        |        |
| Current                          | 66     | 84     | 81     |
| Deferred                         | 12     | (7)    | (9)    |
| Total state                      | 78     | 77     | 72     |
| Foreign:                         |        |        |        |
| Current                          | 94     | 138    | 118    |
| Deferred                         | (7)    | (4)    | (9)    |
| Total foreign                    | 87     | 134    | 109    |
| Total provision for income taxes | \$ 628 | \$ 716 | \$ 627 |

Tax benefits associated with the exercise of employee stock options and other employee stock programs were allocated to shareholders' equity in the amount of \$2, \$62, and \$42, in 2009, 2008, and 2007, respectively.

The reconciliation between the statutory tax rate and the effective rate for 2009, 2008, and 2007 is as follows:

|                                       | 2009  | 9     | 2008  | 3     | 2007  | 7     |
|---------------------------------------|-------|-------|-------|-------|-------|-------|
| Federal taxes at statutory rate       | \$599 | 35.0% | \$699 | 35.0% | \$598 | 35.0% |
| State taxes, net                      | 48    | 2.8   | 51    | 2.6   | 43    | 2.5   |
| Foreign taxes, net                    | (19)  | (1.1) | (23)  | (1.2) | (7)   | (0.4) |
| Tax (provision) benefit on unremitted |       |       |       |       |       |       |
| earnings                              | (1)   | (0.1) | 4     | 0.2   | _     | _     |
| Other                                 | 1     | 0.1   | (15)  | (8.0) | (7)   | (0.4) |
| Total                                 | \$628 | 36.7% | \$716 | 35.8% | \$627 | 36.7% |

The components of the deferred tax assets and liabilities are as follows:

|                                  | 2009  | 2008  |
|----------------------------------|-------|-------|
| Stock options                    | \$117 | \$ 98 |
| Deferred income/membership fees  | 94    | 62    |
| Excess foreign tax credits       | _     | 4     |
| Accrued liabilities and reserves | 408   | 431   |
| Other                            | 48    | 59    |
| Total deferred tax assets        | 667   | 654   |
| Property and equipment           | 403   | 351   |
| Merchandise inventories          | 184   | 146   |
| Translation gain                 |       | 5     |
| Total deferred tax liabilities   | _587  | 502   |
| Net deferred tax assets          | \$ 80 | \$152 |

The deferred tax accounts at the end of 2009 and 2008 include current deferred income tax assets of \$247 and \$261, respectively, included in deferred income taxes and other current assets; non-current deferred income tax assets of \$7 and \$5, respectively, included in other assets; current deferred income tax liabilities of \$0 and \$1, respectively, included in other current liabilities; and non-current deferred income tax liabilities of \$174 and \$114, respectively, included in deferred income taxes and other liabilities.

The effective income tax rate on earnings was 36.7% in 2009, 35.8% in 2008, and 36.7% in 2007. During 2008 and 2007, the Company distributed \$104 and \$120 respectively in earnings from its Canadian operations. In 2009, the distribution was not material.

The Company has not provided for U.S. deferred taxes on cumulative undistributed earnings of certain non-U.S. affiliates, including its 50% owned investment in the Mexico corporate joint venture, aggregating \$1,554 and \$1,235 at the end of 2009 and 2008, respectively, as such earnings are deemed indefinitely reinvested. Because of the availability of U.S. foreign tax credits and complexity of the computation, it is not practicable to determine the U.S. federal income tax liability or benefit associated with such earnings if such earnings were not deemed to be indefinitely reinvested.

### Note 10—Net Income Per Common and Common Equivalent Share

The following table shows the amounts used in computing net income per share and the effect on income and the weighted average number of shares of dilutive potential common stock (shares in 000's).

|  | 2009                      | 2008                      | 2007                      |
|--|---------------------------|---------------------------|---------------------------|
| Net income available to common stockholders used in basic net income per share   | \$1,086<br>1              | \$1,283<br>1              | \$1,083<br>1              |
| Net income available to common stockholders after assumed conversions of dilutive securities                           | \$1,087                   | \$1,284                   | \$1,084                   |
| Weighted average number of common shares used in basic net income per share  | 433,988<br>5,072<br>1,394 | 434,442<br>8,268<br>1,530 | 447,659<br>7,621<br>2,361 |
| Weighted number of common shares and dilutive potential of common stock used in diluted net income per share per share | 440,454                   | 444,240                   | 457,641                   |
| Anti-dilutive stock options and RSUs   | 8,045                     | 11                        | 692                       |

### **Note 11—Commitments and Contingencies**

### Legal Proceedings

The Company is involved from time to time in claims, proceedings and litigation arising from its business and property ownership. The Company is a defendant in the following matters, among others:

Two cases purportedly brought as class actions on behalf of certain present and former Costco managers in California, in which plaintiffs principally allege that they have not been properly compensated for overtime work. Scott M. Williams v. Costco Wholesale Corp., United States District Court (San Diego), Case No. 02-CV-2003 NAJ (JFS); Greg Randall v. Costco Wholesale Corp., Superior Court for the County of Los Angeles, Case No. BC-296369. On February 21, 2008 the court in Randall tentatively granted in part and denied in part plaintiffs' motion for class certification. That order was finalized by the court on May 13, 2008. The parties in Randall have agreed on a partial settlement of the action (resolving all claims except for the miscalculation claim), requiring a payment of up to \$16 by the Company, which was reserved for in 2008. The Court granted final approval of the settlement on June 22, 2009. Settlement distribution is underway. The miscalculation claim from the Randall case was refiled as a separate action by stipulation, alleging that the Company miscalculated the rates of pay for all department and ancillary managers in California in violation of Labor Code Section 515(d). On October 2, 2009, the court granted the Company's motion for summary judgement. Terry Head v. Costco Wholesale Corp., Superior Court for the County of Los Angeles, Case No. BC-409805. In the Williams action, the parties have achieved a settlement in principle for a gross amount of \$440 thousand. Any settlement will be subject to court approval.

On December 26, 2007, another putative class action was filed, also principally alleging denial of overtime compensation. The complaint alleges misclassification of certain California managers. On March 6, 2008, Costco filed a motion to dismiss. On May 15, 2008, the court partially granted the motion, dismissing certain claims and refusing to expand the statute of limitations for the remaining claims. An answer to the complaint was filed on May 27, 2008. Plainiff's class certification motion is pending. Jesse Drenckhahn v. Costco Wholesale Corp., United States District Court (Los Angeles), Case No. CV08-1408 FMC (JMJ).

A case purportedly brought as a class action on behalf of present and former hourly employees in California, in which the plaintiff principally alleges that the Company's routine closing procedures and security checks cause employees to incur delays that qualify as uncompensated working time and that effectively deny them statutorily guaranteed meal periods and rest breaks. The complaint was filed on October 2, 2008, and the Company's motion to dismiss was partially granted. Discovery is ongoing. Anthony Castaneda v. Costco Wholesale Corp., Superior Court for the County of Los Angeles, Case No. BC-399302. A similar purported class action was filed on May 15, 2009, on behalf of present and former hourly employees in California, claiming denial of wages and false imprisonment during the post-closing jewelry and till "pull," when security measures allegedly cause employees to be locked in the warehouses. This complaint has not yet been served on the Company. Mary Pytelewski v. Costco Wholesale Corp., Superior Court for the County of San Diego, Case No. 37-2009-00089654.

A putative class action, filed on January 24, 2008, purportedly brought on behalf of two groups of former California employees—an "Unpaid Wage Class" and a "Wage Statement Class." The "Unpaid Wage Class" alleges that the Company improperly deducts employee credit card balances from final paychecks, while the "Wage Statement Class" alleges that final paychecks do not contain the accurate and itemized information legally required for wage statements. On May 29, 2008, the court granted in part a motion to dismiss, dismissing with prejudice the wage-itemization claims. On May 5, 2009, the Court denied the Company's motion for summary judgment. Plaintiff's class certification motion is pending. Carrie Ward v. Costco Wholesale Corp., United States District Court (Los Angeles), Case No. CV08-02013 FMC (FFM).

Claims in these actions are made under various provisions of the California Labor Code and the California Business and Professions Code. Plaintiffs seek restitution/disgorgement, compensatory damages, various statutory penalties, punitive damages, interest, and attorneys' fees.

A case brought as a class action on behalf of certain present and former female managers, in which plaintiffs allege denial of promotion based on gender in violation of Title VII of the Civil Rights Act of 1964 and California state law. Shirley "Rae" Ellis v. Costco Wholesale Corp., United States District Court (San Francisco), Case No. C-04-3341-MHP. Plaintiffs seek compensatory damages, punitive damages, injunctive relief, interest and attorneys' fees. Class certification was granted by the district court on January 11, 2007. On May 11, 2007, the United States Court of Appeals for the Ninth Circuit granted a petition to hear the Company's appeal of the certification. The appeal was argued on April 14, 2008. Proceedings in the district court have been stayed during the appeal. The parties await a decision from the Ninth Circuit.

Class actions stated to have been brought on behalf of certain present and former Costco members:

In Evans, et ano, v. Costco Wholesale Corp., No. BC351869 (Superior Court for the County of Los Angeles), and Dupler v. Costco Wholesale Corp., Index No. 06-007555 (commenced in the Supreme Court of Nassau County, New York and removed to the United States District Court for the Eastern District of New York), it is asserted that the Company violated various provisions of California and New York common law and statutes in connection with a membership renewal practice. Under that practice, members who paid their renewal fees late generally had their twelve-month membership renewal periods commence at the time of the prior year's expiration rather than the time of the late payment. Plaintiffs in these two actions seek compensatory damages, restitution, disgorgement, preliminary and permanent injunctive and declaratory relief, attorneys' fees and costs, prejudgment interest and, in Evans, punitive damages. On April 2, 2009, the district court preliminarily approved a settlement that, if finally approved, will resolve both of these actions. The settlement entails a provisional certification of a nationwide class of present and former Costco members who from March 1, 2001, to March 31, 2009, paid their membership renewal fees late and had their renewal periods commence at the prior year's expiration date rather than the date of payment. Depending upon

their individual circumstances, class members can be eligible for up to a three-month extension of their current membership or, if they are no longer Costco members, a temporary membership of up to three months. Other than payments to two class representatives, the settlement does not provide for cash payments to class members. The Company has agreed not to oppose a request for an award of attorneys' fees to class counsel in an amount up to \$5. A hearing is set for October 16, 2009, for the court to consider whether the settlement should receive final approval. In the third quarter of 2009, the Company recorded an adjustment to deferred membership fees of \$27 and a reserve was established in the amount of \$7 to cover the expected costs of the certificates, payment of attorneys' fees to class counsel, and certain expenses of settlement administration. Further details of the proposed settlement can be obtained from the notice to class members, which can be viewed at http://www.costco.com/renewalsettlement.pdf.

Numerous putative class actions have been brought around the United States against motor fuel retailers, including the Company, alleging that they have been overcharging consumers by selling gasoline or diesel that is warmer than 60 degrees without adjusting the volume sold to compensate for heat-related expansion or disclosing the effect of such expansion on the energy equivalent received by the consumer. The Company is named in the following actions: Raphael Sagalyn, et al., v. Chevron USA, Inc., et al., Case No. 07-430 (D. Md.); Phyllis Lerner, et al., v. Costco Wholesale Corporation, et al., Case No. 07-1216 (C.D. Cal.); Linda A. Williams, et al., v. BP Corporation North America, Inc., et al., Case No. 07-179 (M.D. Ala.); James Graham, et al. v. Chevron USA, Inc., et al., Civil Action No. 07-193 (E.D. Va.); Betty A. Delgado, et al., v. Allsups, Convenience Stores, Inc., et al., Case No. 07-202 (D.N.M.); Gary Kohut, et al. v. Chevron USA, Inc., et al., Case No. 07-285 (D. Nev.); Mark Rushing, et al., v. Alon USA, Inc., et al., Case No. 06-7621 (N.D. Cal.); James Vanderbilt, et al., v. BP Corporation North America, Inc., et al., Case No. 06-1052 (W.D. Mo.); Zachary Wilson, et al., v. Ampride, Inc., et al., Case No. 06-2582 (D. Kan.); Diane Foster, et al., v. BP North America Petroleum, Inc., et al., Case No. 07-02059 (W.D. Tenn.); Mara Redstone, et al., v. Chevron USA, Inc., et al., Case No. 07-20751 (S.D. Fla.); Fred Aguirre, et al. v. BP West Coast Products LLC, et al., Case No. 07-1534 (N.D. Cal.); J.C. Wash, et al., v. Chevron USA, Inc., et al.; Case No. 4:07cv37 (E.D. Mo.); Jonathan Charles Conlin, et al., v. Chevron USA, Inc., et al.; Case No. 07 0317 (M.D. Tenn.); William Barker, et al. v. Chevron USA, Inc., et al.; Case No. 07-cv-00293 (D.N.M.); Melissa J. Couch, et al. v. BP Products North America, Inc., et al., Case No. 07cv291 (E.D. Tex.); S. Garrett Cook, Jr., et al., v. Hess Corporation, et al., Case No. 07cv750 (M.D. Ala.); Jeff Jenkins, et al. v. Amoco Oil Company, et al., Case No. 07-cv-00661 (D. Utah); and Mark Wyatt, et al., v. B. P. America Corp., et al., Case No. 07-1754 (S.D. Cal.). On June 18, 2007, the Judicial Panel on Multidistrict Litigation assigned the action, entitled In re Motor Fuel Temperature Sales Practices Litigation, MDL Docket No 1840, to Judge Kathryn Vratil in the United States District Court for the District of Kansas. On February 21, 2008, the court denied a motion to dismiss the consolidated amended complaint. On April 12, 2009, the Company agreed to a settlement involving the actions in which it is named as a defendant. Under the settlement, which is subject to approval by the court, the Company has agreed, to the extent allowed by law, to install over five years from the effective date of the settlement temperature-correcting dispensers in the States of Alabama, Arizona, California, Florida, Georgia, Kentucky, Nevada, New Mexico, North Carolina, South Carolina, Tennessee, Texas, Utah, and Virginia. Other than payments to class representatives, the settlement does not provide for cash payments to class members. On August 18, 2009, the court preliminarily approved the settlement and set a hearing for April 1, 2010, to consider final approval of the settlement. Further details of the proposed settlement can be obtained from the notice to class members, which can be viewed at http://www.costco.com/fuelsettlement.pdf.

The Company has been named as a defendant in two purported class actions relating to sales of organic milk. Hesse v. Costco Wholesale Corp., No. C07-1975 (W.D. Wash.); Snell v. Aurora Dairy Corp., et al., No. 07-CV-2449 (D. Col.). Both actions claim violations of the laws of various states, essentially alleging that milk provided to Costco by its supplier Aurora Dairy Corp. was improperly labeled "organic." Plaintiffs filed a consolidated complaint on July 18, 2008. With respect to the

Company, plaintiffs seek to certify four classes of people who purchased Costco organic milk. Aurora has maintained that it has held and continues to hold valid organic certifications. The consolidated complaint seeks, among other things, actual, compensatory, statutory, punitive and/or exemplary damages in unspecified amounts, as well as costs and attorneys' fees. On June 3, 2009, the court entered an order dismissing with prejudice, among others, all claims against the Company. Plaintiffs have appealed the dismissal.

The Company has been named as a defendant in a purported class action relating to sales of farm-raised salmon. Farm Raised Salmon Coordinated Proceedings, Los Angeles Superior Court Case No. JCCP No. 4329. The action alleges that the Company violated California law requiring farm-raised salmon to be labeled as "color added." The complaint asserts violations of the California Unfair Competition Law, the California Consumer Legal Remedies Act, and the California False Advertising Law, and negligent misrepresentation, and seeks restoration of money acquired by means of unfair competition or false advertising and compensatory damages in unspecified amounts, injunctive relief remedying the allegedly improper disclosures, and costs and attorneys' fees. A California Superior Court ruling dismissing the action on the ground that federal law does not permit claims for mislabeling of farm-raised salmon to be asserted by private parties was reversed by the California Supreme Court. The Company has denied the material allegations of the complaint.

The Company has been named as a defendant in a purported nationwide class action relating to sales of certain waffles, which alleges that labeling (provided by the Company's supplier) of these items was deceptive and misleading. Hodes, et al., v. Van's International Foods, et al., United States District Court for the Central District of California, Case No. CV 09-01530. The complaint asserts causes of action for fraud, breach of warranty, false advertising under California Business and Professions Code sections 17500 et seq., and unfair business practices under California Business and Professions Code sections 17200 et seq. Relief sought includes compensatory, consequential, and punitive damages, restitution, prejudgment interest, costs, and attorneys' fees. By orders dated June 23, and July 23, 2009, the district court dismissed the fraud claim against the Company and denied the plaintiffs' motion for class certification. On September 23, 2009, the district court dismissed the action for lack of jurisdiction. Plaintiff is seeking to appeal the denial of class certification.

In Verzani v. Costco Wholesale Corp., No. 09 CV 2117 (United States District Court for the Southern District of New York), a purported nationwide class action, the plaintiffs allege claims for breach of contract and violation of the Washington Consumer Protection Act, based on the failure of the Company to disclose on the label of its "Shrimp Tray with Cocktail Sauce" the weight of the shrimp in the item as distinct from the accompanying cocktail sauce, lettuce, and lemon wedges. The complaint seeks various forms of damages (including compensatory and treble damages and disgorgement and restitution), injunctive and declaratory relief, attorneys' fees, costs, and prejudgment interest. On April 21, 2009, the plaintiff filed a motion for a preliminary injunction, seeking to prevent the Company from selling the shrimp tray unless the Company separately discloses the weight of the shrimp and provides shrimp consistent with the disclosed weight. By orders dated July 29 and August 6, 2009, the court denied the preliminary injunction motion and dismissed the claim for breach of contract. Plaintiffs are appealing.

Three shareholder derivative lawsuits have been filed, ostensibly on behalf of the Company, against certain of its current and former officers and directors, relating to the Company's stock option grants. One suit, Sandra Donnelly v. James Sinegal, et al., Case No. 08-2-23783-4 SEA (King County Superior Court), was filed in Washington state court on or about July 17, 2008. Plaintiff alleges, among other things, that individual defendants breached their fiduciary duties to the Company by "backdating" grants of stock options issued between 1997 and 2005 to various current and former executives, allegedly in violation of the Company's shareholder-approved stock option plans. The complaint asserts claims for unjust enrichment, breach of fiduciary duties, and waste of corporate assets, and

seeks damages, corporate governance reforms, an accounting, rescission of certain stock option grants, restitution, and certain injunctive and declaratory relief, including the declaration of a constructive trust for certain stock options and proceeds derived from the exercise of such options. On April 3, 2009, on the Company's motion the court dismissed the action, following the plaintiff's disclosure that she had ceased to own Costco common stock, a requirement for her to pursue a derivative action. The second action, Pirelli Armstrong Tire Corp. Retiree Medical Benefits Trust v. James Sinegal, et al., Case No. 2:08-cv-01450-TSZ (United States District Court for the Western District of Washington), was filed on or about September 29, 2008, and names as defendants all but one of the Company's directors and certain of its senior executives. Plaintiff alleges that defendants approved the issuance of backdated stock options, concealed the backdating of stock options, and refused to vindicate the Company's rights by pursuing those who obtained improper incentive compensation. The complaint asserts claims under both state law and the federal securities laws and seeks relief comparable to that sought in the state court action described above. Plaintiff further alleges that the misconduct occurred from at least 1997, and continued until 2006, and that as a result virtually all of the Company's SEC filings and financial and other public statements were false and misleading throughout this entire period (including, but not limited to, each of the Company's annual financial statements for fiscal years 1997 through 2007 inclusive). Plaintiff alleges, among other things, that defendants caused the Company to falsely represent that options were granted with exercise prices that were not less than the fair market value of the Company's stock on the date of grant and issuance when they were not, to conceal that its internal controls and accounting controls were grossly inadequate, and to grossly overstate its earnings. In addition, it is further alleged that when the Company announced in October 2006 that it had investigated its historical option granting practices and had not found fraud that announcement itself was false and misleading because, among other reasons, it failed to report that defendants had consistently received options granted at monthly lows for the grant dates and falsely suggested that backdating did not occur. Plaintiff also alleges that false and misleading statements inflated the market price of the Company's common stock and that certain individual defendants sold, and the Company purchased, shares at inflated prices. The third action, Daniel Buckfire v. James D. Sinegal, et al., No. 2:09-cv-00893-TSZ (United States District Court for the Western District of Washington), was filed on or about June 29, 2009, and contains allegations substantially similar to those in the Pirelli action. On August 12, 2009, the court entered an order consolidating the Pirelli and Buckfire actions. On October 2, 2009, plaintiffs Pirelli and Buckfire filed a consolidated amended complaint, to which the defendants have yet to respond. That complaint is largely similar to previous filings, except that: it challenges additional grants (in 1995, 1996, and 2004) and alleges that additional federal securities law filings, including proxy statements and SEC Forms 10-K, Forms 10-Q and related officer certifications (generally from 1996 through and including 2008) were false and misleading for failure to adequately disclose circumstances surrounding grants of options; and now includes as defendants only the following individuals: James D. Sinegal, Richard A. Galanti, Jeffrey H. Brotman, Hamilton E. James, John W. Meisenbach, Jill S. Ruckelshaus, Charles T. Munger, Benjamin S. Carson, Sr., Richard D. DiCerchio, and David S. Petterson.

On October 4, 2006, the Company received a grand jury subpoena from the United States Attorney's Office for the Central District of California, seeking records relating to the Company's receipt and handling of hazardous merchandise returned by Costco members and other records. The Company is cooperating with the inquiry and at this time cannot reasonably estimate any loss that may arise from this matter.

The Environmental Protection Agency (EPA) issued an Information Request to the Company, dated November 1, 2007, under the Clean Air Act. The EPA is seeking records regarding warehouses in the states of Arizona, California, Hawaii, and Nevada relating to compliance with regulations concerning air-conditioning and refrigeration equipment. On March 4, 2009, the Company was advised by the Department of Justice that the Department was prepared to allege that the Company has committed at least nineteen violations of the leak-repair requirements of 40 C.F.R. § 82.156(i) and at least seventy-

four violations of the recordkeeping requirements of 40 C.F.R. § 82.166(k), (m) at warehouses in these four states. The Company has responded to these allegations, is engaged in communications with the Department about these and additional allegations made by letter dated September 10, 2009, and has entered into a tolling agreement.

An Information Request, dated January 14, 2008, has also been received concerning a warehouse in New Hampshire. Substantial penalties may be levied for violations of the Clean Air Act. In April 2008 the Company received an information request from the South Coast Air Quality Management District concerning certain locations in Southern California. The Company has responded to that request. The Company is cooperating with these inquiries and at this time cannot reasonably estimate any loss that might arise from these matters.

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

Except where indicated otherwise above, a reasonable estimate of the possible loss or range of loss cannot be made at this time for the matters described. The Company does not believe that any pending claim, proceeding or litigation, either alone or in the aggregate, will have a material adverse effect on the Company's financial position; however, it is possible that an unfavorable outcome of some or all of the matters, however unlikely, could result in a charge that might be material to the results of an individual fiscal quarter.

## Note 12—Segment Reporting

The Company and its subsidiaries are principally engaged in the operation of membership warehouses in the United States, Canada, Japan, Australia, the United Kingdom, and through majority-owned subsidiaries in Taiwan and Korea and through a 50%-owned joint-venture in Mexico. The Company's reportable segments are based on management's organization of the operating segments for making operational decisions and assessments of financial performance, which considers geographic locations. The investment in the Mexico joint-venture is only included in total assets under United States Operations in the table below, as it is accounted for under the equity method and its operations are not consolidated in the Company's financial statements.

|                               | United States<br>Operations(a) | Canadian<br>Operations | Other<br>International<br>Operations | Total    |
|-------------------------------|--------------------------------|------------------------|--------------------------------------|----------|
| Year Ended August 30, 2009    |                                |                        |                                      |          |
| Total revenue                 | \$56,548                       | \$ 9,737               | \$5,137                              | \$71,422 |
| Operating income              | 1,273                          | 354                    | 150                                  | 1,777    |
| Depreciation and amortization | 589                            | 90                     | 49                                   | 728      |
| Capital expenditures, net     | 904                            | 135                    | 211                                  | 1,250    |
| Property and equipment, net   | 8,415                          | 1,394                  | 1,091                                | 10,900   |
| Total assets                  | 17,228                         | 2,641                  | 2,110                                | 21,979   |
| Net assets                    | 7,458                          | 1,470                  | 1,090                                | 10,018   |
| Year Ended August 31, 2008    |                                |                        |                                      |          |
| Total revenue                 | \$56,903                       | \$10,528               | \$5,052                              | \$72,483 |
| Operating income              | 1,393                          | 420                    | 156                                  | 1,969    |
| Depreciation and amortization | 511                            | 92                     | 50                                   | 653      |
| Capital expenditures, net     | 1,190                          | 246                    | 163                                  | 1,599    |
| Property and equipment, net   | 8,016                          | 1,371                  | 968                                  | 10,355   |
| Total assets                  | 16,345                         | 2,477                  | 1,860                                | 20,682   |
| Net assets                    | 6,882                          | 1,292                  | 1,018                                | 9,192    |
| Year Ended September 2, 2007  |                                |                        |                                      |          |
| Total revenue                 | \$51,532                       | \$ 8,724               | \$4,145                              | \$64,401 |
| Operating income              | 1,217                          | 287(b                  | ) 105                                | 1,609    |
| Depreciation and amortization | 449                            | 73                     | 44                                   | 566      |
| Capital expenditures, net     | 1,105                          | 207                    | 74                                   | 1,386    |
| Property and equipment, net   | 7,357                          | 1,237                  | 926                                  | 9,520    |
| Total assets                  | 15,577                         | 2,280                  | 1,750                                | 19,607   |
| Net assets                    | 6,451                          | 1,157                  | 1,015                                | 8,623    |

The material accounting policies of the segments are the same as those described in Note 1. All intersegment net sales and expenses are immaterial and have been eliminated in computing total revenue and operating income.

<sup>(</sup>a) Certain home office operating expenses are incurred on behalf of the Company's Canadian and other international operations, but are included in the United States operations above because those costs are not allocated internally and generally come under the responsibility of the Company's United States management team.

<sup>(</sup>b) Includes a \$39 charge related to protecting employees from adverse tax consequences resulting from the Company's internal review of its historical stock option grant practices in 2006 of certain stock options (See Note 7).

## Note 13—Quarterly Financial Data (Unaudited)

The two tables that follow reflect the unaudited quarterly results of operations for 2009 and 2008.

52 Weeks Ended August 30, 2009 Third **First** Second Fourth Quarter Quarter Quarter Quarter Total 12 Weeks 12 Weeks 12 Weeks 16 Weeks 52 Weeks **REVENUE** \$ 69,889 \$ 16,036 \$ 16,488 \$ 15,477 \$ 21,888 Net sales ...... 359 355 490 1,533 329(a) 16,395 16,843 71,422 15,806 22,378 **OPERATING EXPENSES** Merchandise costs ..... 14,276 14,771 13,776 19,512 62,335 Selling, general and administrative ...... 1,677 1,666 1,655 2,254 7,252 Preopening expenses ..... 13 9 12 41 Provision for impaired assets and closing 7 1 7 2 17 1,777 Operating income ..... 422 398 359 598 OTHER INCOME (EXPENSE) Interest expense ..... (25)(25)(25)(33)(108)18 8 4 15 45 415 INCOME BEFORE INCOME TAXES ..... 381 338 580 1,714 Provision for income taxes ..... 152 142 128 206 628 263 239 \$ 210 374 1,086 NET INCOME ..... \$ \$ \$ \$ **NET INCOME PER COMMON SHARE:** \$ \$ 0.61 \$ 0.55 \$ 0.86 \$ 2.50 0.48 \$ \$ 0.55 \$ \$ \$ Diluted ..... 0.60 0.48 0.85 2.47 Shares used in calculation (000's) 432,451 433,476 434,354 435,255 433,988 440,533 439,997 440,454 Diluted ..... 439,688 441,699 Dividends per share ..... 0.160 \$ 0.160 0.180 0.18 \$ 0.68

<sup>(</sup>a) Includes a \$27 decrease to membership fees related to a proposed litigation settlement concerning our membership renewal policy (See Note 11—Commitments and Contingencies).

52 Weeks Ended August 31, 2008

|   | Qu | irst<br>arter<br>Veeks    | Qu | cond<br>arter<br>Veeks    | Q  | hird<br>uarter<br>Weeks     | Qı | ourth<br>ıarter<br>Weeks  | otal<br>Veeks            |
|---|----|---------------------------|----|---------------------------|----|-----------------------------|----|---------------------------|--------------------------|
| REVENUE   |    |                           |    | -                         |    |                             |    |                           |                          |
| Net sales Membership fees   | \$ | 15,472<br>338             | \$ | 16,616<br>343             | \$ | 16,263<br>351               | \$ | 22,626<br>474             | \$<br>70,977<br>1,506    |
| Total revenue   |    | 15,810                    |    | 16,959                    |    | 16,614                      |    | 23,100                    | 72,483                   |
| OPERATING EXPENSES  |    |                           |    |                           |    |                             |    |                           |                          |
| Merchandise costs   |    | 13,824                    |    | 14,833                    |    | 14,548                      |    | 20,298(b)                 | 63,503                   |
| Selling, general and administrative                                     |    | 1,570                     |    | 1,615                     |    | 1,582                       |    | 2,187                     | 6,954                    |
| Preopening expenses Provision for impaired assets and closing           |    | 21                        |    | 10                        |    | 9                           |    | 17                        | 57                       |
| costs, net  |    | _                         |    | (3)                       |    | 9                           |    | (6)                       | _                        |
| Operating income OTHER INCOME (EXPENSE)                                 |    | 395                       |    | 504                       |    | 466                         |    | 604                       | 1,969                    |
| Interest expense  |    | (23)                      |    | (23)                      |    | (25)                        |    | (32)                      | (103)                    |
| Interest income and other   |    | `33 <sup>°</sup>          |    | `41                       |    | 24                          |    | `35 <sup>°</sup>          | `133 <sup>′</sup>        |
| INCOME BEFORE INCOME TAXES  |    | 405                       |    | 522                       |    | 465                         |    | 607                       | 1,999                    |
| Provision for income taxes  |    | 143                       |    | 194                       |    | 170                         |    | 209                       | 716                      |
| NET INCOME  | \$ | 262                       |    | 328                       |    | 295                         | \$ | 398                       | \$<br>1,283              |
| NET INCOME PER COMMON SHARE:  |    |                           |    |                           |    |                             |    |                           |                          |
| Basic   | \$ | 0.60                      | \$ | 0.75                      | \$ | 0.68                        | \$ | 0.92                      | \$<br>2.95               |
| Diluted   | \$ | 0.59                      | \$ | 0.74                      | \$ | 0.67                        | \$ | 0.90                      | \$<br>2.89               |
| Shares used in calculation (000's)  Basic  Diluted  Dividends per share | 4  | 35,090<br>45,717<br>0.145 | 4  | 34,779<br>44,925<br>0.145 | 4  | 133,678<br>143,281<br>0.160 | 4  | 34,282<br>43,874<br>0.160 | 34,442<br>44,240<br>0.61 |

<sup>(</sup>b) Includes a \$32 increase to merchandise costs for a LIFO inventory adjustment (See Note 1—Merchandise Inventories).

# Note 14—Subsequent Events

The Company evaluated subsequent events and transactions for potential recognition or disclosure in the financial statements through October 16, 2009, the day the consolidated financial statements were issued.

#### **DIRECTORS AND OFFICERS**

#### **DIRECTORS**

Jeffrey H. Brotman

Chairman of the Board, Costco

Dr. Benjamin S. Carson, Sr., M.D.

Director of Pediatric Neurosurgery, Johns Hopkins University

Susan L. Decker

Entrepreneur-in-Residence (EIR) at Harvard Business School; Former President of Yahoo! Inc.

Richard D. DiCerchio

Senior Executive Vice President, COO – Global Operations, Distribution and Construction, Costco

Daniel J. Evans

Chairman, Daniel J. Evans Associates; Former U.S. Senator and Governor of the State of Washington

Richard A. Galanti

**Executive Vice President and Chief** 

Financial Officer, Costco

William H. Gates

Co-Chair of the Bill and Melinda Gates Foundation

Hamilton E. James

President and Chief Operating Officer,

The Blackstone Group

Richard M. Libenson

Former COO and Vice Chairman of the Board,

The Price Company

John W. Meisenbach

President of MCM, A Meisenbach Company

Charles T. Munger

Vice Chairman of the Board of Berkshire Hathaway, Inc.; Chairman of the Board of Daily Journal Corporation; and Chairman and CEO of Wesco Financial Corporation

Jeffrey S. Raikes

CEO of the Bill and Melinda Gates Foundation

Jill S. Ruckelshaus

Director, Lincoln National Corporation

James D. Sinegal

President and Chief Executive Officer, Costco

#### **EXECUTIVE AND SENIOR OFFICERS**

Joel Benoliel

Senior Vice President, Administration & Chief Legal Officer

Andree Brien

Senior Vice President, Merchandising - Non-Foods & Ecommerce - Canadian Division

Jeffrev H. Brotman

Chairman of the Board

**Don Burdick** 

Senior Vice President, Information Systems

Charles V. Burnett

Senior Vice President, Pharmacy

Roger A. Campbell

Senior Vice President, General Manager – Southeast Region

Richard C. Chavez

Senior Vice President, Costco Wholesale Industries & **Business Development** 

Richard D. DiCerchio

Senior Executive Vice President, COO - Global Operations, Distribution & Construction

John B. Gaherty

Senior Vice President, General Manager – Midwest Region

Richard A. Galanti

Executive Vice President, Chief Financial Officer

Jaime Gonzalez

Senior Vice President, General Manager - Mexico

**Bruce Greenwood** 

Senior Vice President, General Manager – Los Angeles

Robert D. Hicok

Senior Vice President, General Manager - San Diego Region

Dennis A. Hoover

Senior Vice President, General Manager - Bay Area Region

W. Craig Jelinek

Executive Vice President, COO - Merchandising

Dennis E. Knapp

Senior Vice President, Merchandising – Non-Foods

Franz Lazarus

Senior Vice President, Administration – Global Operations

Jeffrey R. Long

Senior Vice President, General Manager - Northeast Region

Jeffrey Lyons Senior Vice President, Merchandising – Fresh Foods

John Matthews

Senior Vice President, Human Resources & Risk Management

John M<sup>Č</sup>Kav

Senior Vice President, General Manager - Northwest Region

Russ Miller

Senior Vice President, General Manager - Western Canada Region

Ali Moayeri

Senior Vice President, Construction

Paul G. Moulton

Executive Vice President, Real Estate Development

James P. Murphy

Senior Vice President, International Operations

David S. Petterson

Senior Vice President, Corporate Controller

Joseph P. Portera

Executive Vice President, COO - Eastern & Canadian Divisions

Pierre Riel

Senior Vice President, General Manager – Eastern Canada Region

Ginnie Roeglin

Senior Vice President, Ecommerce & Publishing

Timothy L. Rose

Senior Vice President, Merchandising – Foods & Sundries

Douglas W. Schutt

Executive Vice President, COO - Northern & Midwest Divisions

James D. Sinegal

President and Chief Executive Officer

John Thelan

Senior Vice President, Operations - Depots

Thomas K. Walker

Executive Vice President, Construction & Distribution

Louise Wendling

Senior Vice President, Country Manager - Canada

Dennis R. Zook

Executive Vice President, COO - Southwest Division & Mexico

#### VICE PRESIDENTS

Jeffrey Abadir

Operations - Bay Area Region

Sandi Babins

GMM - Foods & Sundries - Western Canada Region

Bryan Blank

Operations - San Diego Region

Chris Bolves

Operations – Northwest Region

John Booth

Operations - Bay Area Region

Alan Bubitz

GMM - Bakery, Service Deli and

Food Court

Deb Cain

GMM – Foods – Northwest Region

**Deborah Calhoun** 

GMM - Foods - San Diego Region

**Patrick Callans** 

Corporate Purchasing and Business

Centers

Richard Chang

Country Manager - Taiwan

Jeff Cole

U.S. Gas Purchasing & Operations

Julie Cruz

Operations - Southeast Region

**Victor Curtis** Pharmacy

Richard Delie

GMM - Corporate Non-Foods

Gerard Dempsey

Operations - Southeast Region

**Preston Draper** 

Country Manager - Korea

John T. Eagan

GMM - Foods - Los Angeles Region

Frank Farcone

Operations – Los Angeles Region

Timothy K. Farmer

GMM - Corporate Non-Foods

**Chris Fleming** 

Operations - Western Canada Region

Murray Fleming

GMM - Hardlines - Canadian Division

Jack S. Frank

Real Estate Development – West

Gary Giacomi

GMM – Non-Foods – Northwest

Region

Lorelle Gilpin

Marketing – Canada

Cynthia Glaser

GMM - Corporate Non-Foods

Joseph Grachek III

Merchandise Accounting Controller

Darby Greek

Operations - Bay Area Region

Nancy Griese

GMM - Corporate Foods

Isaac Hamaoui

GMM - Hardlines - Canadian Division

Bill Hanson

GMM - Foods - Midwest Region

Doris Harley

GMM - Foods - Southeast Region

**David Harruff** 

Operations – Northwest Region

**Timothy Haser** 

Information Systems

James Hayes

Operations – Northwest Region

Daniel M. Hines

Financial Accounting Controller

Mitzi Hu

GMM – Imports

**Ross Hunt** 

Human Resources, Finance & IS -Canadian Division

Arthur D. Jackson, Jr.

Administration & Community Giving

Harold E. Kaplan

Corporate Treasurer

James Klauer

GMM - Corporate Non-Foods

Gary Kotzen

GMM - Corporate Foods

Paul Latham

Membership, Marketing, Services & Costco Travel

Robert Leuck

Operations – Northeast Region

Gerry Liben

GMM - Ancillaries - Canadian

Division

Phil Lind

**Business Centers** 

Steve Mantanona

GMM - Merchandising - Mexico

Tracy Mauldin-Avery

GMM - Foods - Bay Area Region

Mark Maushund

Operations - Los Angeles Region

Susan McConnaha

Operations – Bakery

John Minola

Real Estate Development

Sarah Mogk

Operations - Depots

Robert E. Nelson

Financial Planning & Investor Relations

Pietro Nenci

GMM - Foods & Sundries - Eastern Canada Region

Court Newberry

**Ecommerce Merchandising** 

David Nickel

GMM – Non-Foods –Western

Canada Region

**Patrick Noone** 

Country Manager - Australia

Richard J. Olin Legal, General Counsel

Mario Omoss Operations - San Diego Region Frank Padilla

GMM - Produce

Steve Pappas

Country Manager – United Kingdom

Shawn Parks

Operations - Los Angeles Region

Mike Parrott

GMM - Corporate Non-Foods

Mike Pollard **Ecommerce Operations** 

Steve Powers

Operations - Southeast Region

Paul Pulver

Operations - Northeast Region

Aldyn Royes

Operations - Southeast Region

Yoram Rubanenko

Operations - Northeast Region

James Rutherford

Information Systems **Drew Sakuma** 

Operations - Midwest Region

Janet Shanks

GMM - Fresh Foods - Canadian

Division

Michael Sinegal International

David Skinner

Operations – Eastern Canada Region

Jim Stafford

GMM - Foods - Northeast Region

Kimberley L. Suchomel

GMM - International

John Sullivan Associate General Counsel & Chief

Compliance Officer

**Gary Swindells** Operations – Eastern Canada Region

Mauricio Talayero Chief Financial Officer - Mexico

Ken Theriault

Country Manager - Japan

Keith H. Thompson

Construction **Adrian Thummler** 

Operations - Mexico

Scott Tyler Operations - Western Canada Region

Ron Vachris

Operations - San Diego Region

Azmina Virani GMM - Softlines - Canadian Division

**Richard Webb** Operations - Texas Region

Jack Weisbly

GMM - Corporate Non-Foods

Shannon West GMM - Corporate Non-Foods

Rich Wilcox Operations - Northeast Region

Charlie A. Winters Operations - Fresh Meat & Service

### ADDITIONAL INFORMATION

A copy of Costco's annual report to the Securities and Exchange Commission on Form 10-K and quarterly reports on Form 10-Q will be provided to any shareholder upon written request directed to Investor Relations, Costco Wholesale Corporation, 999 Lake Drive, Issaguah, Washington 98027. Internet users can access recent sales and earnings releases, the annual report and SEC filings, as well as our Costco Online web site, at http://www.costco.com. E-mail users may direct their investor relations questions to investor@costco.com. All of the Company's filings with the SEC may be obtained at the SEC's Public Reference Room at Room 1580, 100 F Street NE, Washington, DC 20549. For information regarding the operation of the SEC's Public Reference Room, please contact the SEC at 1-800-SEC-0330. Additionally, the SEC maintains an internet site that contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC at www.sec.gov.

# **Corporate Office**

999 Lake Drive Issaguah, WA 98027 (425) 313-8100

#### **Division Offices**

**Northern Division** Northwest Region

1045 Lake Drive Issaguah, WA 98027

Bay Area Region

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Midwest Region

1901 West 22nd Street, 2nd Floor Oak Brook, IL 60523

**Southwest Division** Los Angeles Region

11000 Garden Grove, #201 Garden Grove, CA 92843

San Diego Region

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Texas Region

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**Eastern Division** Northeast Region

45940 Horseshoe Drive, Suite 150 Sterling, VA 20166

Southeast Region

3980 Venture Drive NW, #W100 Duluth, GA 30096

**Canadian Division** Eastern Region

> 415 Hunt Club Road West Ottawa, ON K2E 1C5

Western Region

4500 Still Creek Drive Burnaby, BC V5C 0E5

**International Division United Kingdom Region** 

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Japan Region

3-1-4 Ikegami-Shincho Kawasaki-ku Kawasaki-shi Kanagawa, 210-0832 Japan

Korea Region

65, 3-ga Yangpyung-dong Youngdeungpo-gu Seoul, Korea 150-963

Taiwan Region

255 Min Shan Street Neihu, Taipei, Taiwan 114

Australia Region

82 Waterloo Rd - Ground Floor North Ryde, NSW Australia 2113

Mexico Region

Boulevard Magnocentro #4 Col. San Fernando La Herradura 52760 Huixquilucan, Mexico

Annual Meeting

Wednesday, January 28, 2010 at 4:00 PM Meydenbauer Center 11100 NE 6th Street Bellevue, Washington 98004

**Independent Public Accountants** 

KPMG LLP

801 Second Avenue, Suite 900 Seattle, WA 98104

Transfer Agent

BNY Mellon Shareowner Services Costco Shareholder Relations P. O. Box 358015 Pittsburgh, PA 15252-8015

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Stock Exchange Listing

NASDAQ Stock Market Stock Symbol: COST

