

COSTCO WHOLESALE CORP /NEW
Form 10-Q
December 21, 2007
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended November 25, 2007

OR

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

Commission file number 0-20355

Costco Wholesale Corporation

(Exact name of registrant as specified in its charter)

Washington
(State or other jurisdiction of
incorporation or organization)

999 Lake Drive, Issaquah, WA 98027

(Address of principal executive office)

(Zip Code)

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

91-1223280
(I.R.S. Employer

Identification No.)

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

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

Large accelerated filer Accelerated filer Non-accelerated filer

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

The number of shares outstanding of the issuer's common stock as of December 14, 2007 was 434,757,248.

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COSTCO WHOLESALE CORPORATION

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PART I FINANCIAL INFORMATION

Item 1 Financial Statements

COSTCO WHOLESALE CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS

(dollars in thousands, except par value)

(unaudited)

| | November 25, 2007 | September 2, 2007 |
|--|----------------------|----------------------|
| ASSETS | | |
| CURRENT ASSETS | | |
| Cash and cash equivalents | \$ 2,742,354 | \$ 2,779,733 |
| Short-term investments | 467,703 | 575,787 |
| Receivables, net | 763,069 | 762,017 |
| Merchandise inventories | 5,773,342 | 4,879,465 |
| Deferred income taxes and other current assets | 555,441 | 327,151 |
| Total current assets | 10,301,909 | 9,324,153 |
| PROPERTY AND EQUIPMENT | | |
| Land | 3,109,417 | 3,009,514 |
| Buildings, leasehold and land improvements | 7,432,070 | 7,035,672 |
| Equipment and fixtures | 2,897,762 | 2,747,243 |
| Construction in progress | 194,265 | 276,087 |
| | 13,633,514 | 13,068,516 |
| Less accumulated depreciation and amortization | (3,713,968) | (3,548,736) |
| Net property and equipment | 9,919,546 | 9,519,780 |
| OTHER ASSETS | | |
| | 782,614 | 762,653 |
| | \$ 21,004,069 | \$ 19,606,586 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| CURRENT LIABILITIES | | |
| Short-term borrowings | \$ 1,440 | \$ 53,832 |
| Accounts payable | 6,168,251 | 5,124,990 |
| Accrued salaries and benefits | 1,243,918 | 1,226,666 |
| Accrued sales and other taxes | 260,738 | 267,920 |
| Deferred membership fees | 751,210 | 692,176 |
| Current portion of long-term debt | 35,358 | 59,905 |
| Other current liabilities | 1,232,840 | 1,156,264 |
| Total current liabilities | 9,693,755 | 8,581,753 |
| LONG-TERM DEBT, excluding current portion | 2,182,308 | 2,107,978 |
| DEFERRED INCOME TAXES AND OTHER LIABILITIES | 295,118 | 224,197 |

| | | |
|---|----------------------|----------------------|
| Total liabilities | 12,171,181 | 10,913,928 |
| COMMITMENTS AND CONTINGENCIES | | |
| MINORITY INTEREST | 70,477 | 69,317 |
| STOCKHOLDERS EQUITY | | |
| Preferred stock \$.005 par value; 100,000,000 shares authorized; no shares issued and outstanding | | |
| Common stock \$.005 par value; 900,000,000 shares authorized; 434,962,000 and 437,013,000 shares issued and outstanding | 2,175 | 2,185 |
| Additional paid-in capital | 3,197,235 | 3,118,224 |
| Accumulated other comprehensive income | 477,520 | 370,589 |
| Retained earnings | 5,085,481 | 5,132,343 |
| Total stockholders equity | 8,762,411 | 8,623,341 |
| | \$ 21,004,069 | \$ 19,606,586 |

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

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COSTCO WHOLESALE CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(dollars in thousands, except per share data)

(unaudited)

| | 12 Weeks Ended | |
|--|-------------------------|-------------------------|
| | November 25, 2007 | November 26, 2006 |
| REVENUE | | |
| Net sales | \$ 15,471,500 | \$ 13,852,321 |
| Membership fees | 338,030 | 299,303 |
| Total revenue | 15,809,530 | 14,151,624 |
| OPERATING EXPENSES | | |
| Merchandise costs | 13,823,511 | 12,388,958 |
| Selling, general and administrative | 1,569,594 | 1,382,467 |
| Preopening expenses | 21,492 | 22,727 |
| Provision for impaired assets and closing costs, net | 79 | 4,332 |
| Operating income | 394,854 | 353,140 |
| OTHER INCOME (EXPENSE) | | |
| Interest expense | (22,968) | (2,140) |
| Interest income and other | 33,277 | 27,111 |
| INCOME BEFORE INCOME TAXES | 405,163 | 378,111 |
| Provision for income taxes | 143,182 | 141,225 |
| NET INCOME | \$ 261,981 | \$ 236,886 |
| NET INCOME PER COMMON SHARE: | | |
| Basic | \$ 0.60 | \$ 0.52 |
| Diluted | \$ 0.59 | \$ 0.51 |
| Shares used in calculation (000 s) | | |
| Basic | 435,090 | 458,873 |
| Diluted | 445,717 | 467,836 |
| Dividends per share | \$ 0.145 | \$ 0.130 |

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

Table of Contents**COSTCO WHOLESALE CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(dollars in thousands)

(unaudited)

| | 12 Weeks Ended | |
|--|----------------------|----------------------|
| | November 25, 2007 | November 26, 2006 |
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net income | \$ 261,981 | \$ 236,886 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 141,494 | 126,976 |
| Stock-based compensation | 38,150 | 32,253 |
| Undistributed equity earnings in joint ventures | (7,012) | (5,233) |
| Net (gain) / loss on sale of property and equipment and other | (3,104) | 1,556 |
| Accretion of discount on long-term debt | 631 | 644 |
| Excess tax benefit from share based awards | (9,195) | (2,203) |
| Other non-cash items, net | 90 | (5,714) |
| Change in deferred income taxes | (4,343) | (2,730) |
| Change in receivables, other current assets, deferred membership fees, accrued and other current liabilities | (97,406) | 15,202 |
| Increase in merchandise inventories | (839,076) | (806,031) |
| Increase in accounts payable | 788,673 | 815,884 |
| Total adjustments | 8,902 | 170,604 |
| Net cash provided by operating activities | 270,883 | 407,490 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Additions to property and equipment, net of \$14,881 and \$19,139 of non-cash capital expenditures in the first fiscal quarters of 2008 and 2007, respectively | (437,067) | (388,800) |
| Proceeds from the sale of property and equipment | 4,731 | 3,408 |
| Purchases of short-term investments | (42,105) | (315,559) |
| Maturities of short-term investments | 119,692 | 434,943 |
| Sales of short-term investments | 37,023 | 438,295 |
| Change in other assets and other, net | (7,092) | (15,393) |
| Net cash (used in) / provided by investing activities | (324,818) | 156,894 |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Changes in bank checks outstanding | 216,778 | 128,312 |
| Proceeds from/ (repayments of) short-term borrowings, net | (53,281) | 13,712 |
| Proceeds from issuance of long-term debt, net | 70,555 | 2,567 |
| Repayment of long-term debt | (31,862) | (1,406) |
| Change in minority interests | 1,160 | 1,097 |
| Excess tax benefit from share based awards | 9,195 | 2,203 |
| Exercise of stock options | 69,491 | 35,930 |
| Repurchases of common stock | (284,168) | (411,649) |
| Net cash used in financing activities | (2,132) | (229,234) |

| | | |
|--|--------------|--------------|
| EFFECT OF EXCHANGE RATE CHANGES ON CASH | 18,688 | (2,988) |
| Net (decrease) / increase in cash and cash equivalents | (37,379) | 332,162 |
| CASH AND CASH EQUIVALENTS BEGINNING OF YEAR | 2,779,733 | 1,510,939 |
| CASH AND CASH EQUIVALENTS END OF PERIOD | \$ 2,742,354 | \$ 1,843,101 |

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:

Cash paid during the period for:

| | | |
|--|-----------|------------|
| Interest (reduced by \$3,731 and \$3,121 interest capitalized in the first fiscal quarters of 2008 and 2007, respectively) | \$ 59,342 | \$ 6,168 |
| Income taxes | \$ 64,161 | \$ 113,154 |

SUPPLEMENTAL DISCLOSURE OF NON-CASH FINANCING ACTIVITIES:

| | | |
|--|-----------|-----------|
| Cash dividend declared, but not yet paid | \$ 63,069 | \$ 59,358 |
| Common stock issued upon conversion of 3.5% Zero Coupon Convertible Subordinated Notes | \$ 102 | \$ 9,191 |

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

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COSTCO WHOLESALE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

(unaudited)

NOTE (1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q for interim financial reporting pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). While these statements reflect all normal recurring adjustments which are, in the opinion of management, necessary for fair presentation of the results of the interim period, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. Therefore, the interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in the Company's annual report filed on Form 10-K for the fiscal year ended September 2, 2007.

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

Costco operates membership warehouses that offer low prices on a limited selection of nationally branded and selected private label products in a wide range of merchandise categories in no-frills, self-service warehouse facilities. At November 25, 2007, Costco operated 494 warehouses: 384 in the United States and four in Puerto Rico; 71 in Canada; 19 in the United Kingdom; six in Japan; five in Korea; and five in Taiwan. The Company's 50% owned joint venture in Mexico operates an additional 30 warehouses.

The Company, in accordance with Financial Accounting Standards Board (FASB) Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109 (FIN 48), adjusted its beginning retained earnings for fiscal 2008 in the accompanying condensed consolidated financial statements. See discussion below for additional information on the adoption of FIN 48.

Fiscal Year End

Costco operates on a 52/53-week fiscal year basis with the fiscal year ending on the Sunday closest to August 31. The fiscal quarters ended November 25, 2007 and November 26, 2006 included 12 weeks.

Merchandise Inventories

Merchandise inventories are valued at the lower of cost or market, as determined primarily by the retail method of accounting, and are stated using the last-in, first-out (LIFO) method for substantially all U.S. merchandise inventories. Merchandise inventories for all foreign operations are primarily valued by the retail method of accounting 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 both November 25, 2007 and September 2, 2007, merchandise inventories valued at LIFO approximated FIFO after considering the lower of cost or market principle.

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NOTE (1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Stock Repurchase Programs

Share repurchases are not displayed separately as treasury stock on the consolidated balance sheets in accordance with the Washington Business Corporation Act, which requires the retirement of repurchased shares. 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 3 for additional information.

Income Taxes

Effective September 3, 2007, the Company adopted FIN 48, which clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with Statement of Financial Accounting Standards (SFAS) No. 109, Accounting for Income Taxes. FIN 48 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 adopting FIN 48 resulted in an increase to the Company's liability for uncertain tax positions of \$6,008. The impact of this adjustment upon adoption was to decrease the beginning balance of retained earnings on the consolidated balance sheet and to increase our liability for uncertain tax positions and related interest by a corresponding amount.

Upon adoption, the Company had approximately \$56,352 of gross unrecognized tax benefits. The total amount of such unrecognized tax benefits upon adoption, that, if recognized, would favorably affect the effective income tax rate in future periods was \$41,749. Interest and penalties related to income tax matters are classified as a component of income tax expense. Accrued interest and penalties upon adoption were \$22,882.

The Company is currently under audit by several taxing jurisdictions in the United States and in several foreign countries. During fiscal 2008, it is reasonably possible that approximately \$16,000 of the unrecognized tax benefit will decrease in connection with settlement related to the deductibility of inter-company interest in a foreign jurisdiction. In addition, it is possible that some audits may conclude in the next 12 months and that the unrecognized tax benefits we have recorded in relation to the audits may differ from 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.

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 2000 to present. No other examinations are material.

Recent Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS 157), which defines fair value, establishes a framework for measuring fair value and expands disclosures about fair-value measurements required under other accounting pronouncements, but does not change existing guidance as to whether or not an instrument is carried at fair value. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within

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NOTE (1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

those fiscal years. In November 2007, the FASB provided a one-year deferral for the implementation of SFAS 157 for nonfinancial assets and liabilities recognized or disclosed at fair value in the financial statements on a nonrecurring basis. Early adoption is permitted. The Company must adopt these new requirements no later than its first quarter of fiscal 2009.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, Including an Amendment to FASB No. 115 (SFAS 159). Under SFAS 159, entities may elect to measure specified financial instruments and warranty and insurance contracts at fair value on a contract-by-contract basis, with changes in fair value recognized in earnings each reporting period. The election, called the fair value option, will enable entities to achieve an offset accounting effect for changes in fair value of certain related assets and liabilities without having to apply complex hedge accounting provisions. SFAS 159 is effective as of the beginning of a company's first fiscal year that begins after November 15, 2007. The Company must adopt these new requirements no later than its first quarter of fiscal 2009.

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.

In December 2007, the FASB issued SFAS No. 141R, Business Combinations (SFAS141R), 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. This statement also establishes disclosure requirements to enable financial statement users to evaluate the nature and financial effects of the business combination. 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 no later than in its first quarter of fiscal 2010.

The Company is in the process of evaluating the impact that adoption of these standards will have on its future consolidated financial statements.

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 period amounts or balances to conform to the presentation adopted in the current fiscal period.

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NOTE (2) LONG-TERM DEBT

During the first quarter of fiscal 2008, \$144 in face amount of the Company's 3.5% Zero Coupon Convertible Subordinated Notes (Zero Coupon Notes) was converted by note holders into 3,000 shares of common stock and during the first quarter of fiscal 2007, \$13,420 in face amount of the Company's Zero Coupon Notes was converted by note holders into 305,000 shares of common stock. These amounts differ from those in the supplemental disclosure of non-cash items in the Statements of Cash Flows due to the related discount and issuance costs.

On October 17, 2007, the Company's wholly-owned Japanese subsidiary issued promissory notes through a private placement in the aggregate amount of \$55,400, bearing interest at 2.695%. Interest is payable semi-annually, and principal is due in October 2017. The proceeds were used, in part, to repay the 2.07% Promissory Notes due on October 23, 2007 in the amount of \$30,600, and the balance will be used for general corporate purposes.

NOTE (3) STOCKHOLDERS' EQUITY

Dividends

The Company's current quarterly cash dividend rate is \$0.145 per share. On November 13, 2007, the Board of Directors declared a quarterly cash dividend of \$0.145 per share to shareholders of record on November 30, 2007. The dividend was paid on December 14, 2007.

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

In the first quarter of fiscal 2008, the Company purchased 4,389,000 shares at an average price of \$61.77, for a total amount of \$271,118. During the first quarter of fiscal 2007, the Company purchased 8,275,000 shares at an average price of \$51.36 for a total amount of \$424,959. These amounts differ from the stock repurchase balances in the statements of cash flows due to repurchases that are accrued at the end of each period.

In September and November 2007, the Board of Directors approved an additional \$300,000 and \$1,000,000, respectively, for stock repurchases, expiring in 2010. At November 25, 2007, the Company had \$1,675,246 available for additional share repurchases.

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 affects.

Table of Contents**NOTE (3) STOCKHOLDERS EQUITY (Continued)**

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

| | 12 Weeks Ended | |
|---|----------------------|----------------------|
| | November 25, 2007 | November 26, 2006 |
| Unrealized gain on short term investments | \$ 4,288 | \$ 2,831 |
| Tax provision | (1,546) | (1,049) |
| Unrealized gain on short-term investments, net of tax | 2,742 | 1,782 |
| Foreign currency translation adjustment and other | 102,846 | (9,248) |
| Tax benefit on translation gain in relation to earnings subject to repatriation | 1,343 | 1,155 |
| Comprehensive income adjustments, net | 106,931 | (6,311) |
| Net income | 261,981 | 236,886 |
| Total comprehensive income | \$ 368,912 | \$ 230,575 |

NOTE (4) 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 restricted stock units (RSUs) under the Second Restated 2002 Plan. Stock options and RSUs generally vest over five years and stock options have a ten-year term. The Company issues new shares of common stock upon exercise of stock options and vesting of RSUs.

Compensation expense for all stock-based awards granted subsequent to fiscal 2002 is recognized using the straight-line method. SFAS 123R requires the estimation of the number of stock-based awards that will ultimately not complete their vesting requirements (forfeitures), and requires that the compensation expense recognized equals or exceeds the number of stock-based awards vested. While options and RSUs generally vest over five years with an equal amount vesting on each anniversary of the grant date, the Company's plans allow for daily 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. As such, the Company does not reduce stock-based compensation for an estimate of forfeitures because this would result in less compensation expense recognized than the number of stock-based awards vested. The impact of actual forfeitures arising in the event of involuntary termination is recognized as actual forfeitures occur.

Summary of Stock Option Activity

The following table summarizes stock option transactions during the twelve weeks ended November 25, 2007:

| | Shares (in 000 s) | Weighted- Average Exercise Price | Weighted- Average Remaining Contractual Term (in years) | Aggregate Intrinsic Value (1) |
|----------------------------------|----------------------|---|--|-------------------------------------|
| Outstanding at September 3, 2007 | 30,088 | \$ 39.26 | | |
| Granted | | | | |
| Exercised | (1,832) | 38.25 | | |

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| | | | | |
|----------------------------------|--------|----------|------|------------|
| Forfeited or expired | (31) | 41.22 | | |
| Outstanding at November 25, 2007 | 28,225 | \$ 39.33 | 5.18 | \$ 780,243 |
| Exercisable at November 25, 2007 | 17,990 | \$ 38.49 | 4.26 | \$ 512,350 |

(1) The difference between the original exercise price and market value at November 25, 2007.

Table of Contents**NOTE (4) STOCK-BASED COMPENSATION PLANS (Continued)**

Tax benefits and intrinsic value related to stock options exercised during the first quarter of fiscal year 2007 and 2006 are provided in the following table:

| | 12 Weeks Ended | |
|---|----------------------|----------------------|
| | November 25, 2007 | November 26, 2006 |
| Actual tax benefit realized for stock options exercised | \$ 16,443 | \$ 7,059 |
| Intrinsic value of stock options exercised | \$ 52,512 | \$ 21,518 |

Employee Tax Consequences on Certain Stock Options

As previously disclosed, in fiscal 2006, the Company initiated an internal review of its historical stock option grant practices to determine whether the stated grant dates of options were supported by the Company's books and records. As a result of this preliminary review, a special committee of independent directors was formed. In connection with this review, and guidance issued by the U.S. Internal Revenue Service on November 30, 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.

As a result of this program, the Company made cash payments totaling \$18,735 to approximately 1,000 employees in the second quarter of fiscal 2007, which resulted in a pre-tax stock compensation charge of \$8,072 (incremental fair value). The difference between the cash payment and the incremental fair value of \$10,663 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.

While the Company is still examining the availability of similar alternatives for employees outside the United States, the Company recorded \$38,300 in selling, general and administrative (SG&A) expense in the second quarter of fiscal 2007 for the estimated charge to remedy adverse tax consequences related to stock options held and previously exercised by employees outside the United States. This amount primarily relates to options exercised from 2004 through the end of the first quarter of fiscal 2007 and represents the estimated payment the Company would make to compensate employees for expected disallowance of the deduction previously allowed for options exercised. The Company has since increased the liability by \$3,805 for options exercised subsequent to the second quarter of fiscal 2007 and through the end of the first quarter of fiscal 2008.

Summary of Restricted Stock Unit Activity

RSUs are granted to employees, non-employee directors, and consultants, which 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. Accordingly, the fair value of RSUs is the quoted market value of the Company's common stock on the date of grant less the present value of the expected dividends forgone during the vesting period. At November 25, 2007, 4.6 million RSUs were available to be granted under the Second Restated 2002 Plan.

The following awards were outstanding as of November 25, 2007:

6,322,300 shares of time-based RSUs in which the restrictions lapse upon the achievement of continued employment over a specified period of time; and

Table of Contents**NOTE (4) STOCK-BASED COMPENSATION PLANS (Continued)**

282,500 performance RSUs granted to certain executive officers of the Company. The performance targets have been met. Further restrictions lapse upon achievement of continued employment over a specified period of time.

305,000 RSUs to be granted to executive officers of the Company upon the achievement of specified performance targets. These awards are not included in the table below.

The following table summarizes RSU transactions during the twelve weeks ended November 25, 2007:

| | Number of Units (in 000 s) | Weighted- Average Grant Date Fair Value |
|---------------------------------|----------------------------------|--|
| Non-vested at September 3, 2007 | 4,779 | \$ 50.63 |
| Granted | 2,532 | 64.92 |
| Vested | (688) | 50.45 |
| Forfeited | (18) | 53.82 |
| Non-vested at November 25, 2007 | 6,605 | \$ 56.12 |

Summary of Stock-Based Compensation

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

| | 12 Weeks Ended | |
|--|----------------------|----------------------|
| | November 25, 2007 | November 26, 2006 |
| Stock options | \$ 17,981 | \$ 21,413 |
| Restricted stock units | 20,169 | 10,840 |
| Total stock-based compensation expense before income taxes | 38,150 | 32,253 |
| Income tax benefit | 12,500 | 10,786 |
| Total stock-based compensation expense, net of income tax | \$ 25,650 | \$ 21,467 |

The remaining unrecognized compensation cost related to non-vested RSUs at November 25, 2007, was \$343,439 and the weighted-average period of time over which this cost will be recognized is 4.3 years. The remaining unrecognized compensation cost related to unvested stock options at November 25, 2007, was \$122,248, and the weighted-average period of time over which this cost will be recognized is 2.0 years.

Table of Contents**NOTE (5) NET INCOME PER COMMON AND COMMON EQUIVALENT SHARE**

The following data show 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.

| | 12 Weeks Ended | |
|---|----------------------|----------------------|
| | November 25, 2007 | November 26, 2006 |
| Net income available to common stockholders used in basic net income per share | \$ 261,981 | \$ 236,886 |
| Interest on convertible notes, net of tax | 246 | 403 |
| Net income available to common stockholders after assumed conversions of dilutive securities | \$ 262,227 | \$ 237,289 |
| Weighted average number of common shares used in basic net income per share (000 s) | 435,090 | 458,873 |
| Stock options and restricted stock units (000 s) | 9,093 | 6,279 |
| Conversion of convertible notes (000 s) | 1,534 | 2,684 |
| Weighted number of common shares and dilutive potential common stock used in diluted net income per share (000 s) | 445,717 | 467,836 |
| Anti-dilutive stock options and RSUs (000 s) | | 10,721 |

NOTE (6) 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. Class certification proceedings are ongoing in *Randall*. *Williams* has been stayed pending the class certification outcome in *Randall*.

An overtime compensation case certified as a class action on behalf of present and former hourly employees in California, in which plaintiffs principally allege that Costco's semi-annual bonus formula is improper with regard to retroactive overtime pay. *Anthony Marin v. Costco Wholesale Corp.*, Superior Court for the County of Alameda, Case No. RG-04150447. Costco has filed an appeal challenging the entry of a \$5.3 million judgment in favor of the class.

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 Costco'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. *Elizabeth Alvarado v. Costco Wholesale Corp.*, United States District Court (San Francisco), Case No. C-06-04015-MJJ. Discovery is ongoing.

Claims in these four 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

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NOTE (6) COMMITMENTS AND CONTINGENCIES (Continued)

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 on January 11, 2007. On May 11, 2007, the United States Court of Appeal for Ninth Circuit granted a petition to hear Costco's appeal of the certification. Proceedings in the district court have been stayed during the appeal.

Class actions stated to have been brought on behalf of certain present and former Costco members. In *Barmak v. Costco Wholesale Corp., et al.*, No. BC348857 (Superior Court for the County of Los Angeles), it is asserted that the Company violated various provisions of the common law and California statutes in connection with its former practice of paying Executive Members who downgraded or terminated their memberships a 2% Reward for less than twelve months of eligible purchases. Plaintiff seeks compensatory damages, restitution, injunctive relief, attorneys' fees and costs, prejudgment interest, and punitive damages. The Court denied the Company's motion to dismiss the complaint in which the Company had asked that the challenged practice, while it was still in effect, was appropriately disclosed to Executive Members. On August 31, 2007, the Court certified a nationwide class in respect of the breach of contract claim and a California class for the remaining claims.

In *Evans, et ano., v. Costco Wholesale Corp.*, No. BC351869 (commenced in the Superior Court for the County of Los Angeles and removed to the United States District Court for the Central District of California), 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 pay their renewal fees late generally have 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. Proceedings concerning class certification are ongoing in *Dupler*.

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. Allsup's, 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-

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NOTE (6) COMMITMENTS AND CONTINGENCIES (Continued)

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. Proceedings are continuing concerning a motion to dismiss a consolidated complaint.

Mimi Serna, Timothy Herrock, et al. v. Costco Wholesale Corp., Case No. 2:07-CV-1491-AHM (JWJx). This is a consumer class action filed in March 2007 in the United States District Court for the Central District of California alleging willful violations of the 15 U.S.C. §1681c(g) of the Fair Credit Reporting Act (FCRA). Section 1681c(g), enacted December 4, 2003, provides that no person that accepts credit cards or debit cards for the transaction of business shall print more than the last five digits of the card number or the expiration date upon any receipt provided to the cardholder at the point of the sale or transaction. Plaintiffs allege that, on or after January 1, 2005, Costco printed the expiration date and/or more than the last five digits of their credit card or debit card number on electronically printed receipts provided at the point of sale involving transactions at Costco's gasoline dispensers throughout the United States. The lawsuit seeks statutory damages, punitive damages, and attorneys' fees. Class certification proceedings are ongoing.

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. Costco has not yet responded to the complaints; Aurora has maintained that it has held and continues to hold valid organic certifications. The complaints seek, among other things, actual, compensatory, statutory, punitive and/or exemplary damages in unspecified amounts, as well as costs and attorneys' fees.

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.

On March 15, 2007, the Company was informed by the U.S. Attorney's Office in the Western District of Washington that the office is conducting an investigation of the Company's past stock option granting practices to determine whether there have been any violations of federal law. As part of this investigation, the U.S. Attorney's Office has served a grand jury subpoena on the Company seeking documents and information relating to its stock option grants. 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. If the EPA determines that violations have occurred, substantial penalties may be levied. At this time the Company cannot reasonably estimate any loss that might arise from this matter.

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 quarter.

Table of Contents**NOTE (7) SEGMENT REPORTING**

The Company and its subsidiaries are principally engaged in the operation of membership warehouses in the United States, Canada, Japan and 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 responsibility. 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 Operations (a) | Canadian Operations | Other International Operations | Total |
|---|------------------------------------|------------------------|--------------------------------------|---------------|
| Twelve Weeks Ended November 25, 2007 | | | | |
| Total revenue | \$ 12,310,166 | \$ 2,405,805 | \$ 1,093,559 | \$ 15,809,530 |
| Operating income | 271,457 | 92,147 | 31,250 | 394,854 |
| Depreciation and amortization | 110,303 | 20,066 | 11,125 | 141,494 |
| Capital expenditures | 329,128 | 77,062 | 30,877 | 437,067 |
| Property and equipment, net | 7,565,421 | 1,379,965 | 974,160 | 9,919,546 |
| Total assets | 16,358,481 | 2,676,835 | 1,968,753 | 21,004,069 |
| Net assets | 6,356,249 | 1,288,327 | 1,117,835 | 8,762,411 |
| Twelve Weeks Ended November 26, 2006 | | | | |
| Total revenue | \$ 11,243,562 | \$ 1,968,818 | \$ 939,244 | \$ 14,151,624 |
| Operating income | 252,747 | 76,065 | 24,328 | 353,140 |
| Depreciation and amortization | 101,475 | 15,636 | 9,865 | 126,976 |
| Capital expenditures | 308,555 | 60,688 | 19,557 | 388,800 |
| Property and equipment, net | 6,891,662 | 1,058,669 | 881,487 | 8,831,818 |
| Total assets | 14,445,335 | 2,206,838 | 1,763,001 | 18,415,174 |
| Net assets | 6,804,450 | 1,182,858 | 984,678 | 8,971,986 |
| Year Ended September 2, 2007 | | | | |
| Total revenue | \$ 51,532,178 | \$ 8,723,562 | \$ 4,144,415 | \$ 64,400,155 |
| Operating income | 1,216,517 | 287,045 | 105,024 | 1,608,586 |
| Depreciation and amortization | 449,338 | 72,915 | 44,132 | 566,385 |
| Capital expenditures | 1,104,461 | 206,840 | 74,398 | 1,385,699 |
| Property and equipment | 7,357,160 | 1,237,031 | 925,589 | 9,519,780 |
| Total assets | 15,543,357 | 2,279,453 | 1,783,776 | 19,606,586 |
| Net assets | 6,417,458 | 1,157,640 | 1,048,243 | 8,623,341 |

The accounting policies of the segments are the same as those described in the notes to the consolidated financial statements included in the Company's annual report filed on Form 10-K for the fiscal year ended September 2, 2007, after considering newly adopted accounting pronouncements described elsewhere herein. All inter-segment net sales and expenses are immaterial and have been eliminated in computing total revenue and operating income.

- (a) Certain home office operating expenses are incurred on behalf of our Canadian operations, but are included in the United States operations above as those costs are not allocated internally and generally come under the responsibility of our United States management team.

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Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations

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. For these purposes, forward-looking statements are 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. These risks and uncertainties include, but are not limited to, domestic and international economic conditions including exchange rates, the effects of competition and regulation, consumer and small business spending patterns and debt levels, conditions affecting the acquisition, development, ownership or use of real estate, actions of vendors, ability to attract, train and retain highly qualified employees, rising costs associated with employees (including health care and workers' compensation costs), rising costs associated with the acquisition of merchandise (including the direct and indirect effects of the rising cost of petroleum-based products and fuel and energy costs), privacy and information security of member related information, geopolitical conditions and other risks identified from time to time in our public statements and reports filed with the Securities and Exchange Commission (SEC).

This management discussion should be read in conjunction with the management discussion included in our fiscal 2007 annual report on Form 10-K previously filed with the SEC.

Overview

We operate membership warehouses based on the concept that offering our members very 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 many competitors.

Key items for the first quarter of fiscal 2008 included:

Net sales increased 11.7% over the prior year, driven by an increase in comparable sales (sales in warehouses open for at least one year) of 8% and the opening of 24 new warehouses (28 opened and 4 closed due to relocations) since the end of the first quarter of fiscal year 2007;

Membership fees increased 12.9% to \$338.0 million, primarily due to the \$5 increase in our annual membership fee in the second half of fiscal 2006 for non-Executive members, as well as increased penetration of our Executive Membership program;

Gross margin (net sales less merchandise costs) as a percentage of net sales increased nine basis points over the prior year's first quarter;

Selling, general and administrative (SG&A) expenses as a percentage of net sales increased 17 basis points over the prior year's first quarter;

Net income increased 10.6% to \$262.0 million from \$236.9 million in the first quarter of fiscal 2007;

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Net income per diluted share increased 15.7% to \$0.59 per diluted share, compared to \$0.51 per diluted share in the first quarter of fiscal 2007;

Table of Contents**Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)**

The Board of Directors declared a quarterly cash dividend in the amount of \$0.145 per share; and

We repurchased 4.4 million shares of our common stock, totaling approximately \$271.1 million, at an average cost of \$61.77 per share.

Results of Operations (dollars in thousands, except earnings per share and warehouse number data)**Net Sales**

| | 12 Weeks Ended | |
|--|----------------------|----------------------|
| | November 25, 2007 | November 26, 2006 |
| Net sales | \$ 15,471,500 | \$ 13,852,321 |
| Increase in comparable warehouse sales | 8.0% | 4.0% |

Net sales increased 11.7% to \$15.47 billion during the first quarter of fiscal 2007, from \$13.85 billion during the first quarter of fiscal 2006. The \$1.62 billion increase in net sales is comprised of \$1.11 billion from the increase in comparable warehouse sales and \$511.6 million primarily from sales at 24 new warehouses opened (28 opened and 4 closed due to relocations) since the end of the first quarter of fiscal 2007. Significantly stronger foreign currencies, particularly in Canada and the United Kingdom, positively impacted net sales by approximately \$355.5 million, or 260 basis points.

Changes in prices of merchandise, with the exception of gasoline prices, did not materially affect the sales increase. Gasoline sales contributed to the \$1.62 billion net sales growth by approximately \$308.3 million, with approximately \$210.7 million of this increase related to the increase in gasoline sales prices, which, on average, increased approximately 21% over the first quarter of fiscal 2007.

Most of the comparable sales growth was derived from increased amounts spent by members visiting our warehouses and increases in frequency of shopping. Gasoline sales positively impacted comparable warehouse sales growth by approximately \$245.4 million, or 180 basis points. Significantly stronger foreign currencies, particularly in Canada and the United Kingdom, positively impacted comparable sales by approximately \$339.4 million, or 250 basis points. Reported comparable sales growth includes the negative impact of cannibalization (established warehouses losing sales to our newly opened locations).

Membership Fees

| | 12 Weeks Ended | |
|---|----------------------|----------------------|
| | November 25, 2007 | November 26, 2006 |
| Membership fees | \$ 338,030 | \$ 299,303 |
| Membership fees as a percent of net sales | 2.19% | 2.16% |
| Total cardholders | 51,000 | 48,500 |

Membership fees increased 12.9% to \$338.0 million, or 2.19% of net sales, in the first quarter of fiscal 2008 from \$299.3 million, or 2.16% of net sales, in the first quarter of fiscal 2007. The increase was primarily due to the \$5 increase in our annual membership fee in the second half of fiscal 2006 for non-Executive members, additional membership sign-ups at the 24 new warehouses opened since the first quarter of fiscal 2007 and increased penetration of the higher-fee Executive Membership program. Our member renewal rate, currently at 86%, is consistent with recent years.

Table of Contents**Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)****Gross Margin**

| | 12 Weeks Ended | |
|--|----------------------|----------------------|
| | November 25, 2007 | November 26, 2006 |
| Gross Margin | \$ 1,647,989 | \$ 1,463,363 |
| Gross margin as a percent of net sales | 10.65% | 10.56% |

Gross margin was \$1.65 billion, or 10.65% of net sales, in the first quarter of fiscal 2008, compared to \$1.46 billion or 10.56% of net sales, in the first quarter of fiscal 2007. The net nine basis point increase in gross margin as a percentage of net sales reflected an increase of 44 basis points in our core merchandise categories, particularly food and sundries, hardlines and fresh foods, which included a three basis point increase relating to improvement in our sales returns reserve. This increase was offset by a net decrease of 30 basis points related to our ancillary businesses, primarily our gasoline business. In addition, increased penetration of the Executive Membership two-percent reward program and increased spending by Executive members negatively affected gross margin by five basis points.

Selling, General and Administrative Expenses

| | 12 Weeks Ended | |
|--|----------------------|----------------------|
| | November 25, 2007 | November 26, 2006 |
| Selling, general and administrative expense (SG&A) | \$ 1,569,594 | \$ 1,382,467 |
| SG&A as a percent of net sales | 10.15% | 9.98% |

SG&A expenses were \$1.57 billion, or 10.15% of net sales, during the first quarter of fiscal 2008, compared to \$1.38 billion, or 9.98% of net sales, during the first quarter of fiscal 2007. Warehouse operating and central administrative costs negatively impacted SG&A comparisons as a percent of net sales by approximately eight basis points, primarily related to payroll and benefits. Additionally, in the first quarter of fiscal 2008, we accrued approximately \$9 million, or six basis points, for compensation adjustments we intend to make 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, beyond what was expected in fiscal 2007. Another three basis points of the increase, as a percentage of net sales, related to an increase in our contingent liability recorded as a result of our plan to mitigate the potential adverse tax consequences related to certain stock options held and previously exercised by employees outside the United States.

Preopening Expenses

| | 12 Weeks Ended | |
|--|----------------------|----------------------|
| | November 25, 2007 | November 26, 2006 |
| Preopening expenses | \$ 21,492 | \$ 22,727 |
| Warehouse openings | 10 | 12 |
| Relocations | (4) | |
| Warehouse openings, net of relocations | 6 | 12 |

Table of Contents**Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)**

Preopening expenses include costs incurred for startup operations related to new warehouses, warehouse remodel projects and the expansion of ancillary operations at existing warehouses. Preopening expenses per warehouse opening can vary due to the timing of the opening relative to our fiscal quarter end, whether the warehouse is owned or leased, whether the opening is in an existing, new or international market as well as the number and magnitude of warehouse remodel projects.

Preopening expenses totaled \$21.5 million during the first quarter of fiscal 2008 compared to \$22.7 million during the first quarter of fiscal 2007. The decrease is largely due to opening fewer warehouses in the first quarter of 2008 compared to the first quarter of fiscal 2007.

Provision for Impaired Assets and Closing Costs, Net

| | 12 Weeks Ended | |
|--|----------------------|----------------------|
| | November 25, 2007 | November 26, 2006 |
| Warehouse closing expenses | \$ 2,684 | \$ 3,713 |
| Impairment of long-lived assets | 592 | |
| Net (gains)/losses on sale of real property | (3,197) | 619 |
| | | |
| Provision for impaired assets and closing costs, net | \$ 79 | \$ 4,332 |

The provision primarily includes costs related to impairment of long-lived assets, future lease obligations of warehouses that have been relocated to new facilities, accelerated depreciation on buildings to be demolished or sold and that are not otherwise impaired, and losses or gains resulting from the sale of real property.

Interest Expense

| | 12 Weeks Ended | |
|------------------|----------------------|----------------------|
| | November 25, 2007 | November 26, 2006 |
| Interest Expense | \$ 22,968 | \$ 2,140 |

Interest expense totaled \$23.0 million in the first quarter of fiscal 2008 compared to \$2.1 million in the first quarter of fiscal 2007. The increase in interest expense for the first quarter of fiscal 2008 compared to first quarter of fiscal 2007 resulted primarily from the additional interest incurred related to the issuance of our \$900 million of 5.3% and \$1.1 billion of 5.5% Senior Notes (2007 Senior Notes) in the third quarter of fiscal 2007.

Interest Income and Other

| | 12 Weeks Ended | |
|-----------------------------|----------------------|----------------------|
| | November 25, 2007 | November 26, 2006 |
| Interest income | \$ 26,099 | \$ 20,608 |
| Earnings of affiliates | 7,171 | 5,608 |
| Minority interest and other | 7 | 895 |
| | | |
| Interest income and other | \$ 33,277 | \$ 27,111 |

Table of Contents**Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)**

Interest income and other totaled \$33.3 million in the first quarter of fiscal 2008 compared to \$27.1 million in the first quarter of fiscal 2007. This increase is largely due to the increase in our cash and cash equivalents and short-term investments resulting from increased cash flows from operations and the proceeds from the issuance of the 2007 Senior Notes, as well as an increase in the earnings of affiliates, primarily our investment in Costco Mexico (a 50%-owned joint venture).

Provision for Income Taxes

| | 12 Weeks Ended | |
|--------------------|----------------------|----------------------|
| | November 25, 2007 | November 26, 2006 |
| Income tax expense | \$ 143,182 | \$ 141,225 |
| Effective tax rate | 35.34% | 37.35% |

The effective income tax rate on earnings was 35.34% in the first quarter of fiscal 2008, compared to 37.35% in the first quarter of fiscal 2007. The effective tax rate for the first quarter of fiscal 2008 was positively impacted by certain positive discrete items of approximately \$7.7 million, which are not expected to reoccur. Excluding these discrete items, the effective tax rate for the first quarter of fiscal 2008 was 37.24%, which is consistent with the effective tax rate currently expected for fiscal 2008.

Net Income

| | 12 Weeks Ended | |
|--|----------------------|----------------------|
| | November 25, 2007 | November 26, 2006 |
| Net income | \$ 261,981 | \$ 236,886 |
| Diluted net income per share | \$ 0.59 | \$ 0.51 |
| Shares used to calculate diluted net income per common share | 445,717 | 467,836 |

Net income for the first quarter of fiscal 2008 increased to \$262.0 million, or \$0.59 per diluted share, from \$236.9 million, or \$0.51 per diluted share, during the first quarter of fiscal 2007, representing a 15.70% increase in diluted net income per share. Since the end of the first quarter of fiscal 2007, we have repurchased 32.5 million shares of common stock, favorably impacting net income per diluted share in the first quarter of fiscal 2008 by approximately \$0.03.

Liquidity and Capital Resources (dollars in thousands, except per share data)***Cash Flows***

The following table itemizes components of our most liquid assets:

| | November 25, 2007 | September 2, 2007 |
|---------------------------|----------------------|----------------------|
| Cash and cash equivalents | \$ 2,742,354 | \$ 2,779,733 |
| Short-term investments | 467,703 | 575,787 |
| Total | \$ 3,210,057 | \$ 3,355,520 |

Our primary sources of liquidity are cash flows generated from warehouse operations and existing cash and cash equivalents and short-term investments balances, which were \$3.21 billion and \$3.36 billion at November 25, 2007 and September 2, 2007,

respectively. Of these balances, approximately

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Item 2 Management s Discussion and Analysis of Financial Condition and Results of Operations (Continued)

\$766.0 million and \$655.2 million at November 25, 2007 and September 2, 2007, respectively, represented debit and credit card receivables, primarily related to weekend sales immediately prior to the quarter-end close. The decrease in our most liquid assets of \$145.5 million to \$3.21 billion at November 25, 2007 was due primarily to the acquisition of property and equipment related to warehouse expansion and the expenditure for the repurchase of our common stock, offset by cash provided from operating activities and an increase in bank checks outstanding.

The markets for certain money fund investments within our cash and cash equivalents portfolio have been experiencing some uncertainty. On December 6, 2007, one of our money fund investments, totaling approximately \$180.0 million, changed to a floating net asset value slightly below one dollar per share. Although future market conditions cannot be predicted, we currently believe that we have no material loss exposure in our cash and cash equivalents portfolio or that we will experience a detriment to our overall liquidity.

Net cash provided by operating activities totaled \$270.9 million in the first quarter of fiscal 2008 compared to \$407.5 million in the first quarter of fiscal 2007. The decrease of \$136.6 million was primarily attributable to a \$200.0 million increase in prepaid insurance resulting from a prepayment for certain employee health care costs.

Net cash used in investing activities totaled \$324.8 million in the first quarter of 2008 compared to \$156.9 million provided in the first quarter of fiscal 2007, an increase of \$481.7 million. The increase in investing activities relates primarily to a decrease in cash provided by the net investment in short-term investments of \$443.1 million, as investments were sold in the first quarter of fiscal 2007, primarily to fund our stock repurchase activity and increased capital expenditures. In the first quarter of fiscal 2008, a lower level of cash was required for these activities due to the issuance of the 5.5% and 5.3% Senior Notes in February 2007.

Net cash used in financing activities totaled \$2.1 million in the first quarter of fiscal 2008, compared to \$229.2 million in the first quarter of fiscal 2007, a decrease of \$227.1 million. The decrease in cash used in financing activities relates primarily to a decrease in the cash used for the repurchase of common stock. In the first quarter of fiscal 2008, we repurchased common stock using \$284.2 million of cash, compared to \$411.6 million in the first quarter of fiscal 2007.

Dividends

Our current quarterly cash dividend rate is \$0.145 per share or \$0.58 per share on an annualized basis. On November 13, 2007, our Board of Directors declared a quarterly cash dividend of \$0.145 per share for shareholders of record on November 30, 2007. The dividend was paid on December 14, 2007.

Expansion Plans

Our primary requirement for capital is the domestic and international financing of land, building and equipment costs for new and remodeled warehouses, plus the costs of initial warehouse operations and working capital requirements. 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 \$1.6 billion to \$1.8 billion during fiscal 2008 for real estate, construction, remodeling and equipment for warehouse clubs and related operations. These expenditures are expected to be financed with a combination of cash provided from operations and the use of cash and cash equivalents and short-term investments. Through the end of the first quarter of fiscal 2008, we spent approximately \$437.1 million.

Table of Contents**Item 2 Management's Discussion and Analysis of Financial Condition and Results of****Operations (Continued)**

We opened 10 new warehouses, including four relocations, in the first quarter of fiscal 2008. Expansion plans during the remainder of fiscal 2008 are to open an additional 24 to 26 new warehouses, inclusive of four to six relocations to larger and better-located facilities.

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

The following table sets forth our bank credit facilities and commercial paper programs as of November 25, 2007 (amounts in thousands):

| Entity | Facility Description | Expiration Date | Total of all Credit Facilities | Credit Line Usage as of 11/25/2007 | | | Available Credit | Applicable Interest Rate |
|--------------------|---|-----------------|--------------------------------|------------------------------------|--|-----------------------------|------------------|--------------------------|
| | | | | Stand-by | Letters of Credit / Letter of Guaranty | Commercial Letter of Credit | | |
| US | Uncommitted Stand By Letter of Credit | N/A | \$ 24,810(4) | \$ 24,810 | \$ | \$ | \$ | N/A |
| US | Uncommitted Commercial Letter of Credit | N/A | 210,000(4) | | 3,710 | | 206,290 | N/A |
| Canada (1) | Commercial Paper Program | N/A | 202,470 | | | | 202,470 | 4.85% |
| Canada (1) | Revolving Credit | March 2008 | 121,482(4) | 25,287 | | | 96,195 | 4.55% |
| Japan (2) | Revolving Credit | February 2008 | 41,667(4) | 9,259 | | | 32,408 | 1.02% |
| Japan (2) | Revolving Credit | February 2008 | 32,407(4) | | | | 32,407 | 1.04% |
| Korea | Multi Purpose Line | March 2008 | 12,901(4) | 1,633 | 245 | | 11,023 | 6.28% |
| Taiwan | Multi Purpose Line | January 2008 | 9,282(4) | 743 | | | 8,539 | 4.50% |
| Taiwan | Revolving Credit | July 2008 | 15,470(4) | 4,131 | | | 11,339 | 4.56% |
| Taiwan | Revolving Credit | March 2008 | 9,282(4) | | | | 9,282 | 4.51% |
| United Kingdom | Revolving Credit | February 2010 | 82,260 | | | | 82,260 | 6.32% |
| United Kingdom | Uncommitted Money Market Line | May 2008 | 41,130 | | | 1,440 | 39,690 | 6.08% |
| United Kingdom | Overdraft Line | May 2008 | 71,978 | | | | 71,978 | 6.75% |
| United Kingdom (3) | Letter of Guarantee | N/A | 7,396(4) | 7,396 | | | | N/A |
| United Kingdom | Commercial Letter of Credit | N/A | 4,113(4) | | 267 | | 3,846 | N/A |

| | | | | | |
|-------|------------|-----------|----------|----------|------------|
| Total | \$ 886,648 | \$ 73,259 | \$ 4,222 | \$ 1,440 | \$ 807,727 |
|-------|------------|-----------|----------|----------|------------|

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- (1) Our wholly-owned Canadian subsidiary has a commercial paper program supported by a revolving credit facility, which we guarantee.
 - (2) Our wholly-owned Japanese subsidiary has a revolving credit facility, which we guarantee.
 - (3) The letter of guarantee is fully cash collateralized by the United Kingdom subsidiary.

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Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)

- (4) We have letter of credit facilities (for commercial and standby letters of credit) totaling \$488.8 million. The outstanding commitments under these facilities at November 25, 2007 totaled \$77.5 million, including \$73.3 million in standby letters of credit.

Financing Activities

During the first quarter of fiscal 2008, \$0.1 million in face amount of our 3.5% Zero Coupon Convertible Subordinated Notes (Zero Coupon Notes) were converted by note holders into 3,000 shares of common stock. During the first quarter of fiscal 2007, \$13.4 million in face amount of our Zero Coupon Notes were converted by note holders into 305,000 shares of common stock.

On October 17, 2007, our wholly-owned Japanese subsidiary issued promissory notes through a private placement, in the aggregate amount of \$55.4 million, bearing interest at 2.695%. Interest is payable semi-annually and principal is due in October 2017. The proceeds were used, in part, to repay the 2.07% Promissory Notes due on October 23, 2007 in the amount of \$30.6 million, and the balance will be used for general corporate purposes.

Derivatives

We have limited involvement with derivative financial instruments and use them only to manage well-defined interest rate and foreign exchange risks. Forward foreign exchange contracts are used to hedge the impact of fluctuations of foreign exchange on inventory purchases and typically have very short terms. These forward contracts do not qualify for derivative hedge accounting. The aggregate notional amount, which approximates the fair value, of foreign exchange contracts outstanding was \$69.5 million and \$75.0 million at November 25, 2007 and September 2, 2007, respectively. The mark-to-market adjustment related to these contracts was \$0.3 million and \$0.9 million at November 25, 2007 and September 2, 2007, respectively. The majority of the forward foreign exchange contracts were entered into by our wholly-owned United Kingdom subsidiary, primarily to hedge U.S. dollar merchandise inventory purchases.

Stock Repurchase Programs

During the first quarter of fiscal 2008, we repurchased 4.4 million shares of our common stock at an average price of \$61.77, totaling approximately \$271.1 million. During the first quarter of fiscal 2007, we repurchased 8.3 million shares, at an average price of \$51.36, for a total amount of \$425.0 million. In September 2007 and November 2007, our Board of Directors approved an additional \$300.0 million and \$1.0 billion respectively, of stock repurchases, both expiring in 2010. The remaining amount available for stock repurchases under the approved plans was approximately \$1.68 billion at November 25, 2007. Purchases are made from time-to-time as conditions warrant in the open market or in block purchases, or pursuant to plans under SEC Rule 10b5-1. Repurchased shares are retired.

Critical Accounting Policies

The preparation of our financial statements requires that we make estimates and judgments. We base our estimates on historical experience and on other assumptions that we believe to be reasonable. A summary of our critical accounting policies are discussed in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations section of our Annual Report on Form 10-K for the fiscal year ended September 2, 2007. There have been no material changes to the critical accounting policies previously disclosed in our Annual Report on Form 10-K for the fiscal year ended September 2, 2007.

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Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)

Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements (SFAS 157), which defines fair value, establishes a framework for measuring fair value and expands disclosures about fair-value measurements required under other accounting pronouncements, but does not change existing guidance as to whether or not an instrument is carried at fair value. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. In November 2007, the FASB provided a one-year deferral for the implementation of SFAS 157 for nonfinancial assets and liabilities recognized or disclosed at fair value in the financial statements on a nonrecurring basis. We must adopt these new requirements no later than our first quarter of fiscal 2009. Early adoption is permitted.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, Including an Amendment to FASB No. 115 (SFAS 159). Under SFAS 159, entities may elect to measure specified financial instruments and warranty and insurance contracts at fair value on a contract-by-contract basis, with changes in fair value recognized in earnings each reporting period. The election, called the fair value option, will enable entities to achieve an offset accounting effect for changes in fair value of certain related assets and liabilities without having to apply complex hedge accounting provisions. SFAS 159 is effective as of the beginning of a company's first fiscal year that begins after November 15, 2007. We must adopt these new requirements no later than our first quarter of fiscal 2009.

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. We must adopt these new requirements in our first quarter of fiscal 2010.

In December 2007, the FASB issued SFAS 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. This statement also establishes disclosure requirements to enable financial statement users to evaluate the nature and financial effects of the business combination. 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. We must adopt these new requirements no later than our first quarter of fiscal 2010.

We are in the process of evaluating the impact that adoption of these statements will have on our future consolidated financial statements.

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Item 3 Quantitative and Qualitative Disclosures About Market Risk

Our exposure to financial market risk results primarily from fluctuations in interest and currency rates. There have been no material changes to our market risks as disclosed in our Annual Report on Form 10-K for the year ended September 2, 2007.

Item 4 Controls and Procedures

As of the end of the period covered by this Quarterly Report on Form 10-Q, 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 Quarterly Report, our disclosure controls and procedures are effective.

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

The certifications required by Section 302 of the Sarbanes-Oxley Act of 2002 are filed as Exhibit 31.1 to this report.

Table of Contents**PART II OTHER INFORMATION****Item 1 Legal Proceedings**

See discussion of Legal Proceedings in Note 6 to the condensed consolidated financial statements included in Part I, Item 1 of this Report.

Item 1A Risk Factors

In addition to the other information set forth in this Quarterly Report on Form 10-Q, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended September 2, 2007. There have been no material changes in our risk factors from those disclosed in our Annual Report on Form 10-K.

Item 2 Unregistered Sales of Equity Securities and Use of Proceeds

The following table sets forth information on our common stock repurchase program activity for the first quarter of fiscal 2008 (amounts in thousands, except per share data):

| Period (1) | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Programs (2) | Maximum Dollar Value of Shares that May Yet be Purchased Under the Programs (2) |
|----------------------------------|----------------------------------|------------------------------|---|---|
| September 3 - September 30, 2007 | 2,575,971 | \$ 59.49 | 2,575,971 | \$ 793,128,272 |
| October 1 - October 28, 2007 | 989,220 | 63.97 | 989,220 | 729,847,641 |
| October 29 - November 25, 2007 | 823,926 | 66.27 | 823,926 | 1,675,246,284 |
| Total First Quarter | 4,389,117 | \$ 61.77 | 4,389,117 | |

(1) Monthly information is presented by reference to our fiscal periods during the first quarter of fiscal 2008.

(2) Our stock repurchase program is conducted under authorizations made by our Board of Directors. The amounts reported in the table are covered by a Board authorization to repurchase shares of common stock of \$2 billion authorized in July 2006 and expiring in July 2009; and \$300 million and \$1 billion authorized in September 2007 and November 2007, respectively, both of which expire in 2010.

Item 3 Defaults Upon Senior Securities

None.

Item 4 Submission of Matters to a Vote of Security Holders

None.

Item 5 Other Information

None.

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Item 6 Exhibits

(a) The following exhibits are included herein or incorporated by reference.

| | |
|--------|---|
| 3.1 | Articles of Incorporation of the Registrant. Incorporated by reference to Form 8-K dated August 30, 1999 |
| 3.2 | Bylaws of the Registrant. Incorporated by reference to Form 10-K dated November 17, 2000 |
| 4.1 | Registrant will furnish upon request copies of instruments defining the rights of holders of its long-term debt instruments |
| 10.6.2 | Fiscal 2008 Executive Bonus Plan (1) |
| 31.1 | Rule 13(a) 14(a) Certifications |
| 32.1 | Section 1350 Certifications |

(1) Incorporated by reference to exhibit filed as part of the Current Report on Form 8-K of Costco Wholesale Corporation dated November 13, 2007

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

COSTCO WHOLESALE CORPORATION

(Registrant)

Date: December 20, 2007

/s/ JAMES D. SINEGAL
James D. Sinegal

President,

Chief Executive Officer

Date: December 20, 2007

/s/ RICHARD A. GALANTI
Richard A. Galanti

Executive Vice President,

Chief Financial Officer