



COSTCO IN AUSTRALASIA
Are they going to stock-up?




June 2004

COSTCO PROFILE

Costco is a \$42.5 billion company that operates wholesale club stores in seven countries

Costco profile (as of FY 2003)

	Name: Costco Wholesale Corporation CEO/President: James D. Sinegal Ownership: Public (Nasdaq: COST)	Address: 999 Lake Dr. Issaquah, WA 98027 United States Telephone: +1 (425) 313 8100	
	Total sales: \$42,546m ¹ Sales CAGR (98-03): 9.8% Operating Income: \$1,157m Operating Income CAGR (98-03): 5.1% Operating Income margin: 2.8% Total assets: \$13,192m ROA (OI/TA): 8.8%	# of employees: 103,000 Sales/employee: \$404,786 # of stores: 407 / 430 incl Mexico Sales/store/week: \$2,010,300 Operating Income/store/week: \$56,045 Supermarket market share in home country: 8% Percent of sales outside home country (ex Mexico) 23%	
Countries (7)		Store Formats	Store Fascias
United States (318) ¹ Canada (62) Mexico (23) ² United Kingdom (15)	South Korea (5) Japan (4) Taiwan (3)	Wholesale Clubs (396) Home Furnishing (1)	Costco

OVERVIEW

Costco will be successful in the Australasian market (Australia and New Zealand)

- 1. Costco is a unique store format able to define and defend a niche position**
- 2. Costco is a world-class retailer able to compete with Australasian chains**
- 3. There is a large pool of likely Costco customers**
- 4. Costco will become a small but significant player in the market**
- 5. Costco will have a diffuse effect spread across a number of different channels**
- 6. Manufacturers need to carefully consider the implications of Costco's market entry**

PROPOSITION ONE

1. Costco is a unique store format able to define and defend a niche position

- **Costco is a wholesale (or membership) club store, a high-volume, limited range store format**
- **The wholesale club store format is positioned as having a lower shopping frequency and less range than a conventional supermarket**
- **Customers have to pay a membership fee of at least US\$45 to shop at Costco**
- **Costco uses membership to create exclusivity and a bond with its customers**
- **Shopping at Costco is a different experience from shopping at other stores**

DEFINITIONS

Costco is a wholesale (or membership) club store, a high-volume, limited range store format

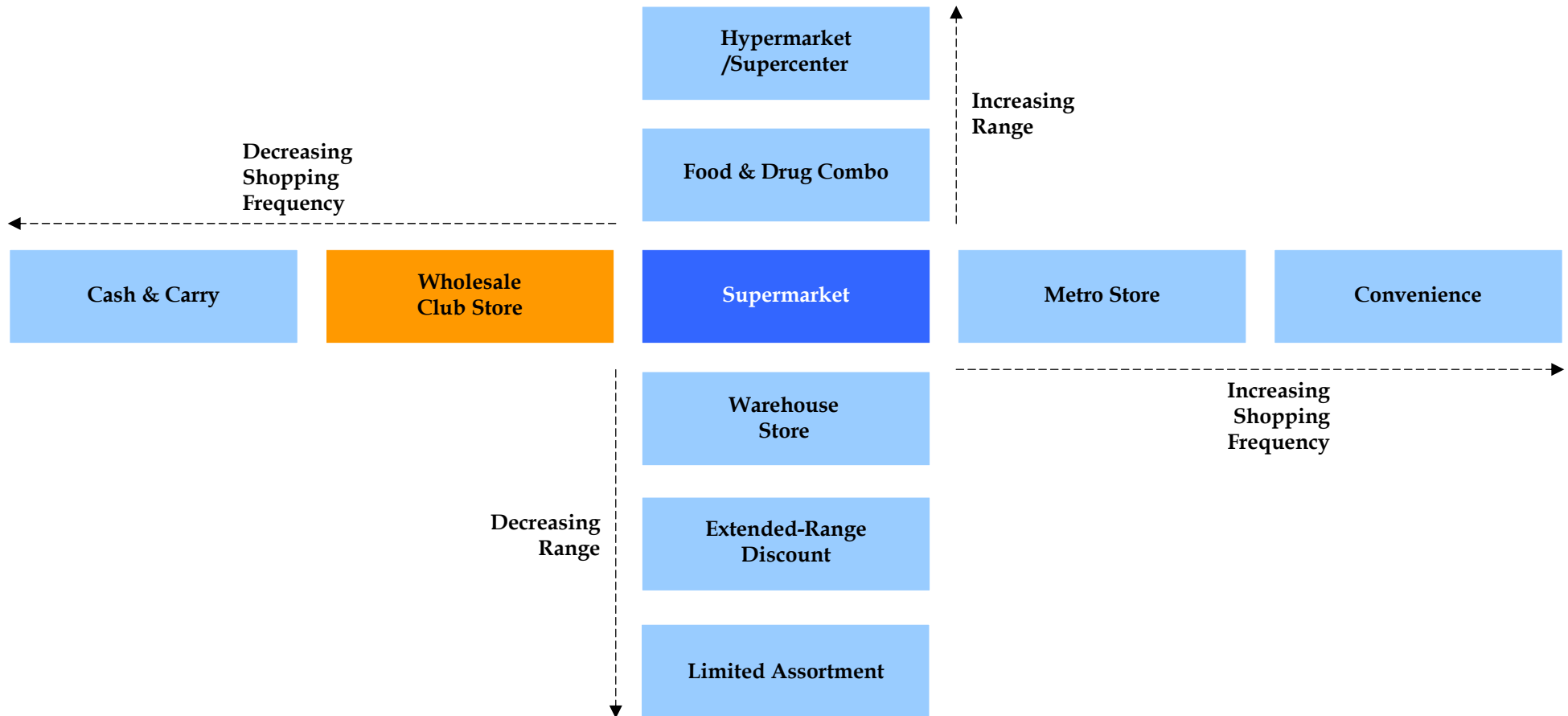
Definitions of major supermarket-type retail store formats
select variables

	Average Size	Average Weekly Sales (\$A)	Average Number of SKU	Average Weekly Sales/m2	Global Segment Leader	Australasian Example
Convenience Store	200-300m2	\$40,000	3,000	\$133	7-Eleven	7-Eleven
Metro Store	800-1,200m2	\$200,000	13,000	\$200	Tesco Metro	Woolworths Metro
Supermarket	2,000-4,000m2	\$350,000	20,000	\$115	Kroger	Coles
Warehouse Store	4,000-7,000m2	\$900,000	10,000	\$150	Cub or Winco	Pak'N Save
Extended-Range Discount	1,000-2,000m2	\$200,000	3,000+	\$135	Colruyt	Franklins
Limited Assortment Discount	600-1,200m2	\$150,000	800-1000	\$190	Aldi	Aldi
Food & Drug Combo	5,000-6,000m2	\$600,000	40,000	\$110	Albertsons	[Illegal] ¹
Hypermarket/Supercenter	10,000-19,000m2	\$1,500,000+	80,000	\$110	Wal-Mart or Carrefour	[Super Kmart]
Wholesale Club Store	10,000m2	\$3,000,000+	4,000	\$300	Costco	[Cost-U-Less]
Cash & Carry	7,000-8,000m2+	\$1,000,000+	12,000-25,000	\$125	Metro/Makro	Campbell's

POSITIONING

The wholesale club store format is positioned as having a lower shopping frequency and less range than a conventional supermarket





Major supermarket-type retail store formats by positioning model



MEMBERSHIP OPTIONS

Customers have to pay a membership fee of at least US\$45 to shop at Costco

Costco Membership structure and fees
\$, actual, 2004

	Type of Membership	# of Members	Annual Cost	Key details
	Gold Star (Consumer) Membership	15.0m	\$45	Individuals who do not qualify for business membership Includes spouse card
	Executive Gold Star Membership		\$100	As individual plus: Executive members receive an annual 2% reward on most Costco purchases Qualify for additional benefits from service providers
	Business Membership	4.6m	\$45	Business identification required when applying Licensed businesses, nonprofit organizations, government agencies, farmers & ranchers Can start shopping at 10am rather than 11am (Monday to Friday) Includes a spouse card; additional business membership cards cost \$35 each
	Executive Business Membership		\$100	As business plus: Executive members receive an annual 2% reward on most Costco purchases Qualify for additional benefits from service providers

*There are 2 million total executive members who account for 25% of sales
No breakout by type (consumer vs. business) is available*

MEMBERSHIP CREATES EXCLUSIVITY

Costco uses membership to create exclusivity and a bond with its customers

- Membership was originally limited to businesses and members of select groups (e.g. government employees) – criteria have since been widened to allow anyone willing to pay to join.
- **“It was unimaginable, this idea, that you could charge people to shop.”** *Michael Exstein, analyst, Shearson, December 1988*
- **“We thought of it as a speak-easy. We tried to create a mystique.”** *Robert Price, President, Price Club, December 1988*
- **“The membership concept is very important to us. First, membership provides a way for us to pre-select the demographics of our customer base without having to do all the extensive research that would otherwise be requires. Business owners and managers, licensed professionals, and people who work for governments, utilities, hospitals or banks tend to be more stable than many other. We take less risk in accepting their checks. Second, dealing exclusively with selected groups makes it possible to communicate with your customers effectively. Instead of communicating with the whole world, you communicate one-on-one with the people you want to reach. Finally, someone who pays for a membership in an organization makes a form of commitment. They have a built-in reason to come back.”** *Sol Price, founder, Price Club, November 1990*
- **“The Costco trick is to lure people in with the promise of bargains and, when they see what's on offer, persuade them to spend more than they intended. Its membership criteria concentrates on those with a pocket deep enough for impulse buying. The poor and unemployed are not invited to this party.”** *Super Marketing, November 1993*
- **“The ‘wholesale’ concept is crucial to the company's image. Wholesale customers account for 60% of total sales.”** *Chain Store Age, May 1983*
- **“Sol Price was the first to realize that by getting certain groups to shop in his store, he could get a high-quality client at a reasonable cost. It pays for whatever marketing budget you need.”** *Walter Teninga, Chairman, Warehouse Club, Nov 1989*

A DIFFERENT SHOPPING EXPERIENCE

Shopping at Costco is a different experience from shopping at other stores

- "I had begun to have a disturbing feeling that everybody in the Bay Area belonged to the Club but me. While I am out at the No-Price-2-Hi store, paying full retail, they're out there in their minivans, loading up on cassette tapes and frozen asparagus...

When we arrived at the huge windowless warehouse, I looked around, riveted, at the stereos, cookware, film, watches, jewelry, liquor gift sets, razor blades, tires, socks, sheets, stationery... I grabbed an oversized orange cart and headed into the crowd. Some people were pushing industrial pallets, piling toilet paper and pancake mix and cases of Kahlua on them as if it had been announced that all buying everywhere in the world would cease in 15 minutes. I began to throw things into my cart, at first slowly, then faster and faster. My list forgotten, I lobbed in everything I saw that I have ever used: a 24-pack of film, a lifetime supply of tampons, 100 plastic tumblers, champagne, couch throws, Christmas wrap, Reeboks I didn't even try on...

Everybody I saw was doing the same thing. It was as if we were all Scarlett O'Hara in *Gone With the Wind*, whispering, "As God is my witness, I'll never pay retail for toilet paper again." Veterans say it's dangerous to let people go to the Price Club alone the first time out. "A gallon jug of maple syrup," the novices think. "What a good idea. A case of gallon jugs of maple syrup - what an even better idea." *Lara Adair, Reporter, San Francisco Chronicle, December 1989*

- "The oversized carts match the oversized purchases, but sometimes even they are not big enough... Unless it's institutional-sized ketchup or jumbo cereal, there's never just one can, box, bottle or carton; two or three or four are packed together. There's never just one kilogram of meat in a tray... Baby carrots are purchased in five-pound bags... A 500-millilitre tub of those hot little feta-stuffed red jalapeños is \$6.95... 15-year-old balsamic vinegar, one litre for \$14.59... At this point, I am becoming embarrassed to admit this sort of wretched excess and feel compelled to say it doesn't happen often. The warehouse club is, after all, an American concept. It was nurtured and flourished in that ultimate land of plenty, where conspicuous consumption is more apt to be a lifestyle... Warehouse club prices *are* hard to beat. But you can't get everything on your shopping list. You end up buying stuff you don't need — lots of it. You walk out spending more than you expected to." *Susan Sampson, Food Writer, Toronto Star, November 2003*

PROPOSITION TWO

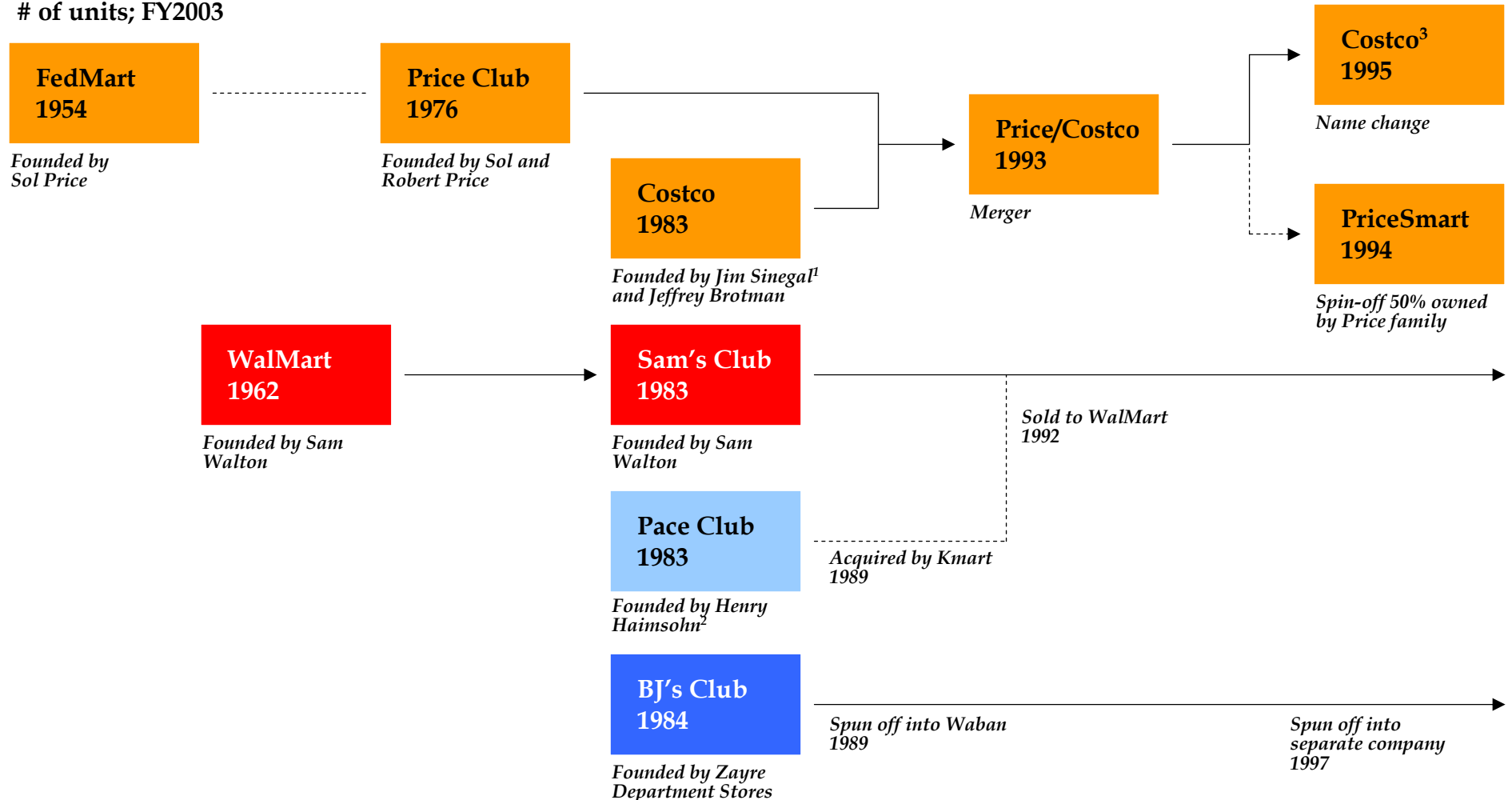
2. Costco is a world-class retailer able to compete with Australasian chains

- Costco is beating Wal-Mart
 - Costco is the product of a merger between Price Club, the originator of the wholesale club, and Costco, the greatest imitator
 - Since the merger Costco has grown at 11% per year and today has total sales 21% greater than Sam's Club while having 141 fewer units
 - As amazing as it sounds, Wal-Mart is the battling underdog of the wholesale club industry
- Costco is now the eighth largest supermarket-type retailer in the world
- Costco is expanding globally and has targeted Australia as its next market
 - There are two major and two minor international players in wholesale clubs and two major international cash-and-carry operators
 - International experience to date in exporting the wholesale club concept suggests it works best in Americanized and high-to-middle income countries
 - While Costco operates 430 units in seven countries, North America accounts for the bulk of turnover
 - To date Costco has entered six additional countries: Canada, Mexico, the United Kingdom, Japan, Korea and Taiwan
 - Australia and New Zealand have been on the radar for more than fifteen years and Costco executives visited Australia and New Zealand last year
- Costco has the financial resources to succeed in Australasia
 - Costco is 2.3 times the size of either Coles Myer or Woolworths based on total turnover
 - Costco achieves higher returns on lower margins than (for example) Coles Myer

COMPANY ORIGIN

Costco is the product of a merger between Price Club, the originator of the wholesale club, and Costco, the greatest imitator

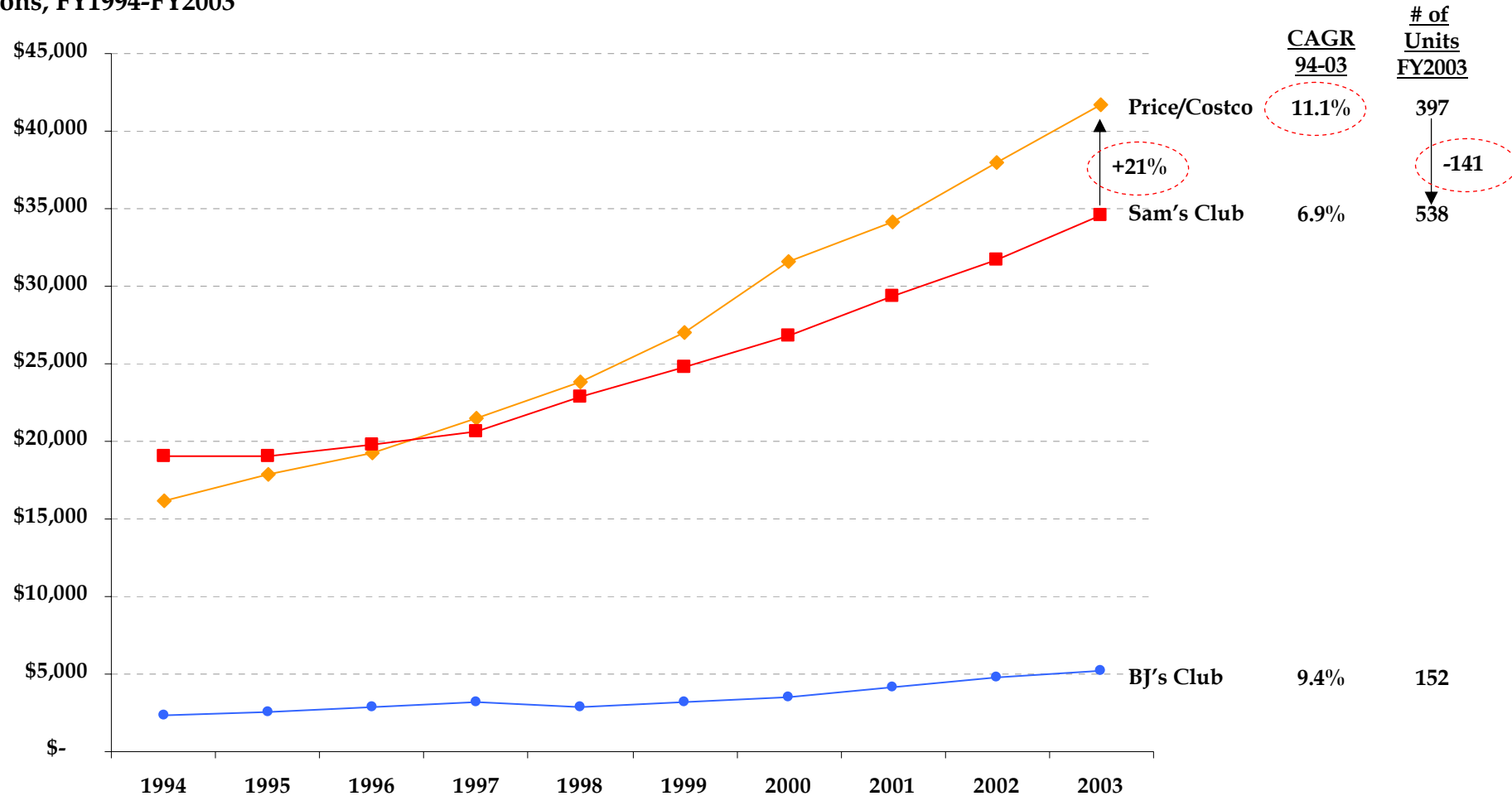
Development of key players in the wholesale club industry
of units; FY2003



GROUP SALES GROWTH

Since the merger Costco has grown at 11% per year and today has total sales 21% greater than Wal-Mart's Sam's Club while having 141 fewer units

Total sales by group
\$, millions, FY1994-FY2003



PITY POOR WAL-MART

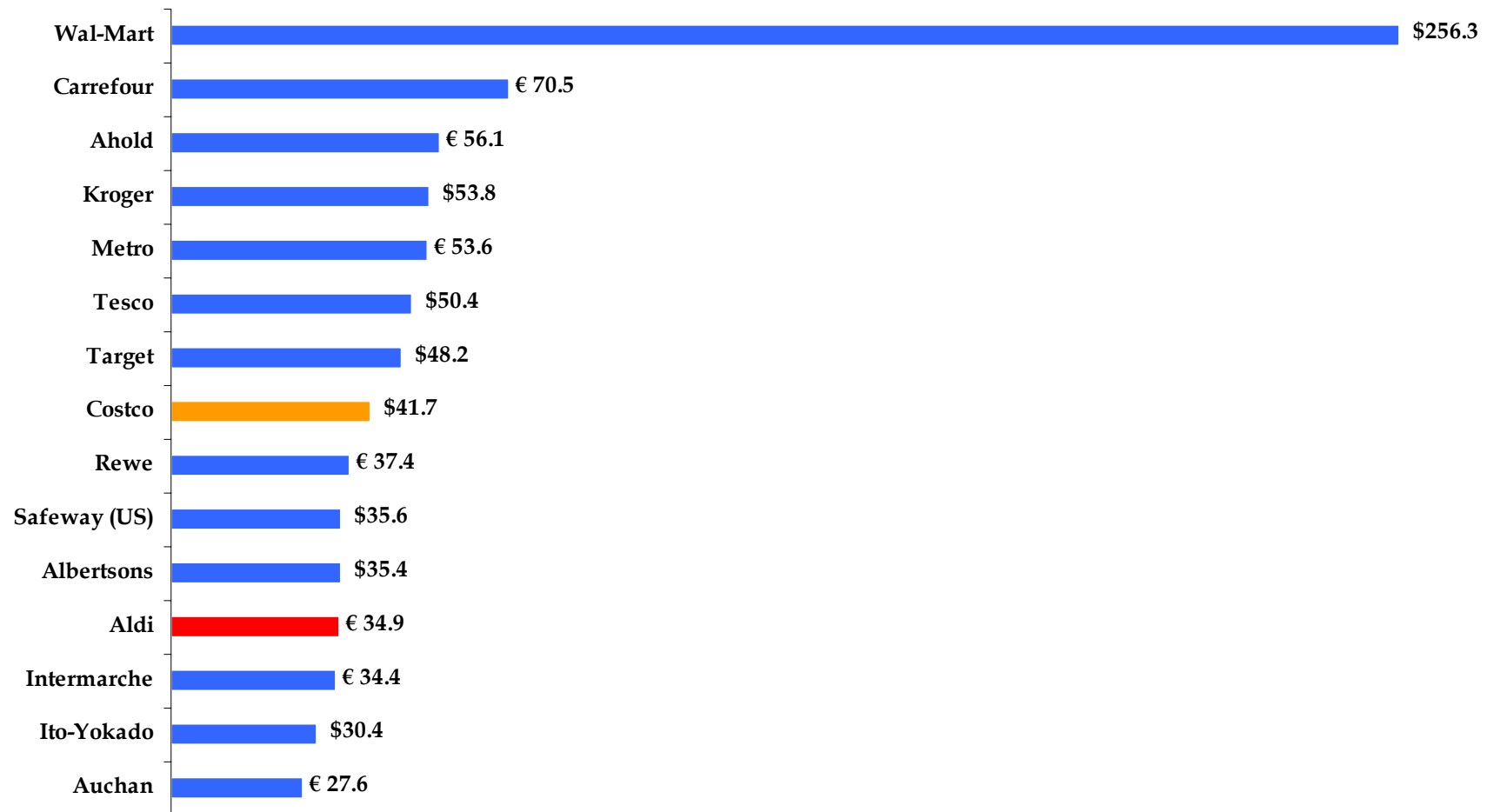
As amazing as it sounds, Wal-Mart is the battling underdog of the wholesale club industry

- **"Regardless of what Wall Street says, Sam Walton can't walk on water. As a matter of fact, neither can I." *Sol Price, Founder, Price Club, March 1989***
- **"Pity poor Wal-Mart (a sentence I never thought I'd write). In this one niche, it's run up against a company that shows you can't discount some old business verities: The nimble first mover can outrun the powerful colossus; the innovator can stay a jump ahead of the imitator; the quality of leadership can trump the quantity of resources." *Fortune, November 2003***
- **"Everybody out there is concerned about saturation. And I think that's partly because when our main competitor, Sam's, announced some management changes a few months ago, as a company they said that part of the reason that they were going to change what they do is that they see saturation in the business. We personally think that some of what they perceive as saturation has been competition from us and we still see lots of opportunities out there." *Richard Galanti, CFO, Costco, May 2003***
- **"The potential for failure is tremendous, but then so is the potential for success." *Ron Loveless, VP, Sam's Clubs, Nov 1983***

TOP 15 GLOBAL SUPERMARKET-TYPE RETAILERS

Costco is now the eighth largest supermarket-type retailer in the world

Top 15 global supermarket-type retailers ranked by sales
US\$/€, billions, FY2003



KEY INTERNATIONAL PLAYERS

There are two major and two minor international players in wholesale clubs and two major international cash-and-carry operators

Facts and figures for key international players

Various, FY2003

Parent Company	Group Sales (\$m)	Fascia	Fascia Sales (\$m)	# of countries	# of units	Sales per unit	Average size (sqft)	# sku per unit	Notes
Major Wholesale Club operators									
Costco	\$42,546m	Costco	\$42,546m (ex-Mexico)	7	430	\$107.2m ⁴	137,000	4,000	23 Mexico units are 50% JV
Wal-Mart	\$256,329m	Sam's Club	\$34,537m ³ (US only)	5	538 US 80 intl	\$64.2m ³	124,000	4,000	53 Mexico units part of Wal-Mart de Mexico
PriceSmart	\$648.5m	PriceSmart	\$649m	16	41	\$23.2m ¹	40,000-50,000	4,000	Price/Costco spin-off
Cost-U-Less	\$177m	Cost-U-Less	\$177m	7	11	\$16.1m	30,000	3,000	Island strategy; failed entry attempt into New Zealand
Major Cash & Carry operators									
Metro AG	\$53,595m	Metro Cash & Carry	\$25,093m	26	475	\$52.8m	70,000-80,000	20,000-30,000	Traditional Cash&Carry operator; purchased part of Makro in the early 1990's
Makro SHV ²	\$10,272m	Makro Cash & Carry	\$2,836m	9	140	\$20.3m	60,000-80,000	20,000-30,000	Stores in Asian and South America; shareholder in Massmart South Africa

INTERNATIONAL EXPERIENCE TO DATE

International experience to date in exporting the wholesale club concept suggests it works best in Americanized and high-to-middle income countries

	Failure	Present	Success	Discussed
High-to-Middle Income	Hong Kong (Sam's) New Zealand (Cost-U-Less)	Japan (Costco) Taiwan (Costco) Korea (Costco)	Canada (Costco, Loblaw, Sam's) United Kingdom (Costco)	Australia (PriceSmart, Costco) New Zealand (PriceSmart, Costco) Portugal (Costco) Spain (Costco) Ireland (Costco) Italy (Costco) Germany (Costco) France (Costco)
Middle-to-Low Income	Argentina (Sam's) Indonesia (PriceSmart) Guam (PriceSmart)	China (Sam's, PriceSmart) Jamaica (PriceSmart) Barbados (PriceSmart) Aruba (PriceSmart) Trinidad (PriceSmart) Dominican Republic Nicaragua (PriceSmart) Honduras (PriceSmart) El Salvador (PriceSmart) Costa Rica (PriceSmart) Guatemala (PriceSmart) Panama (PriceSmart) Philippines (PriceSmart) Micronesia (PriceSmart) Guam (Cost-U-Less) US Virgin Is. (Cost-U-Less) Am. Samoa (Cost-U-Less) Fiji (Cost-U-Less) Neth. Antilles (Cost-U-Less)	Mexico (Costco, Sam's, PriceSmart)	Poland (Costco) Russia (Price Club)

COSTCO CORPORATE STRUCTURE

While Costco operates 430 units in seven countries, North America accounts for the bulk of turnover

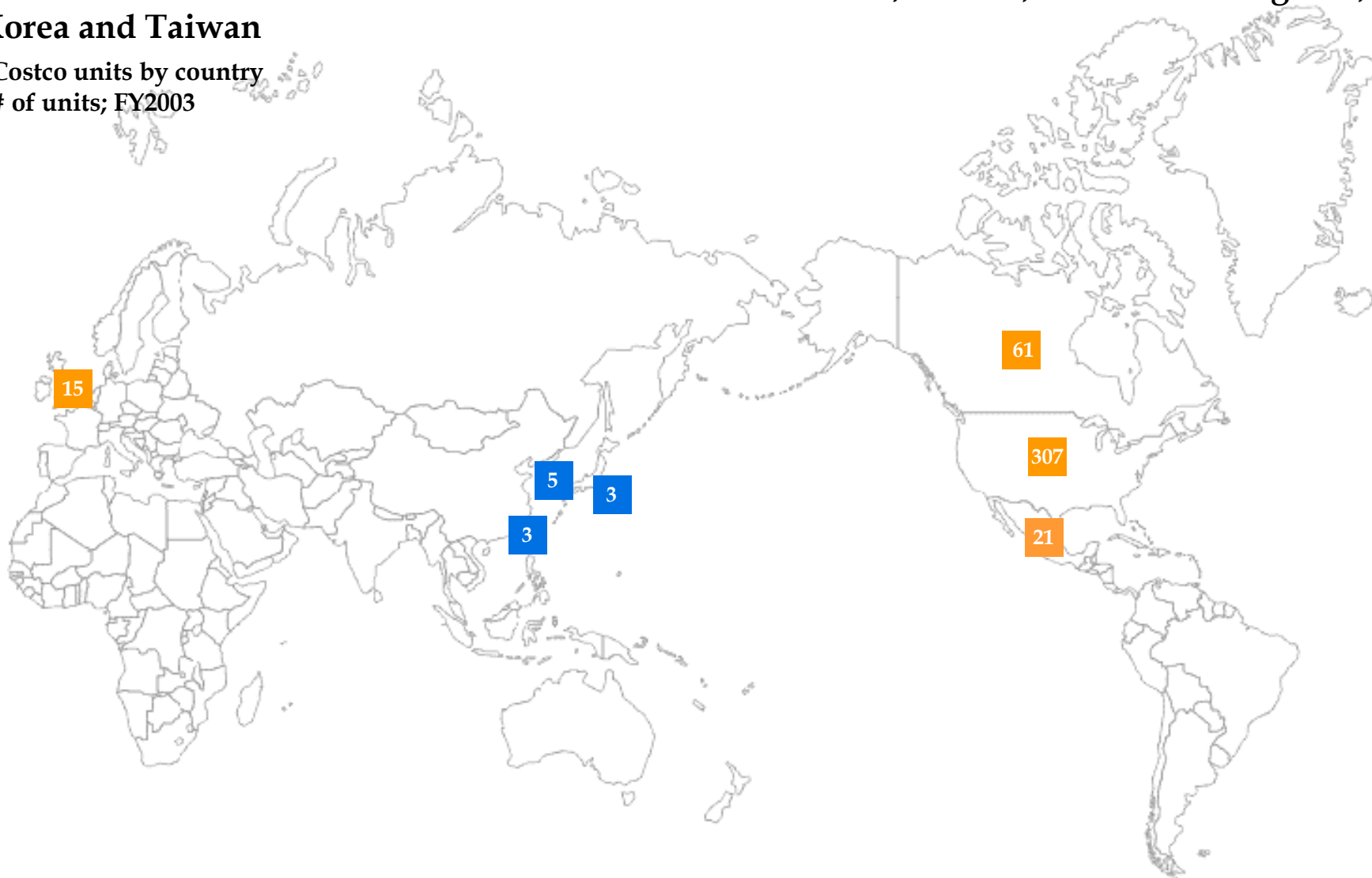
Costco international sales and structure
US\$, millions, FY2003



COSTCO GLOBAL UNITS BY COUNTRY

To date Costco has entered six additional countries: Canada, Mexico, the United Kingdom, Japan, Korea and Taiwan

Costco units by country
of units; FY2003



AUSTRALIA AND NEW ZEALAND ON THE RADAR FOR 15 YEARS

Australia and New Zealand have been on the radar for more than fifteen years...

- "We've had a number of approaches to go into Australia." *Sol Price, Founder, Price Club, March 1989*
- "Specified Geographical Areas shall mean Australia, New Zealand, the Northern Mariana Islands, the Republic of Panama..." *Agreement of transfer and plan of exchange between Price/Costco and Price Enterprises, July 28, 1994*
- "[Price Enterprises] has an exclusive right through August 1999 to conduct club businesses in Central America, most of the Caribbean, the Northern Mariana Islands, Australia and New Zealand, with certain trademark rights to the names Price Club, PriceCostco and Price Club Costco in these markets." *Price Enterprises 10K 1995*

RECENT AUSTRALIA AND NEW ZEALAND VISIT

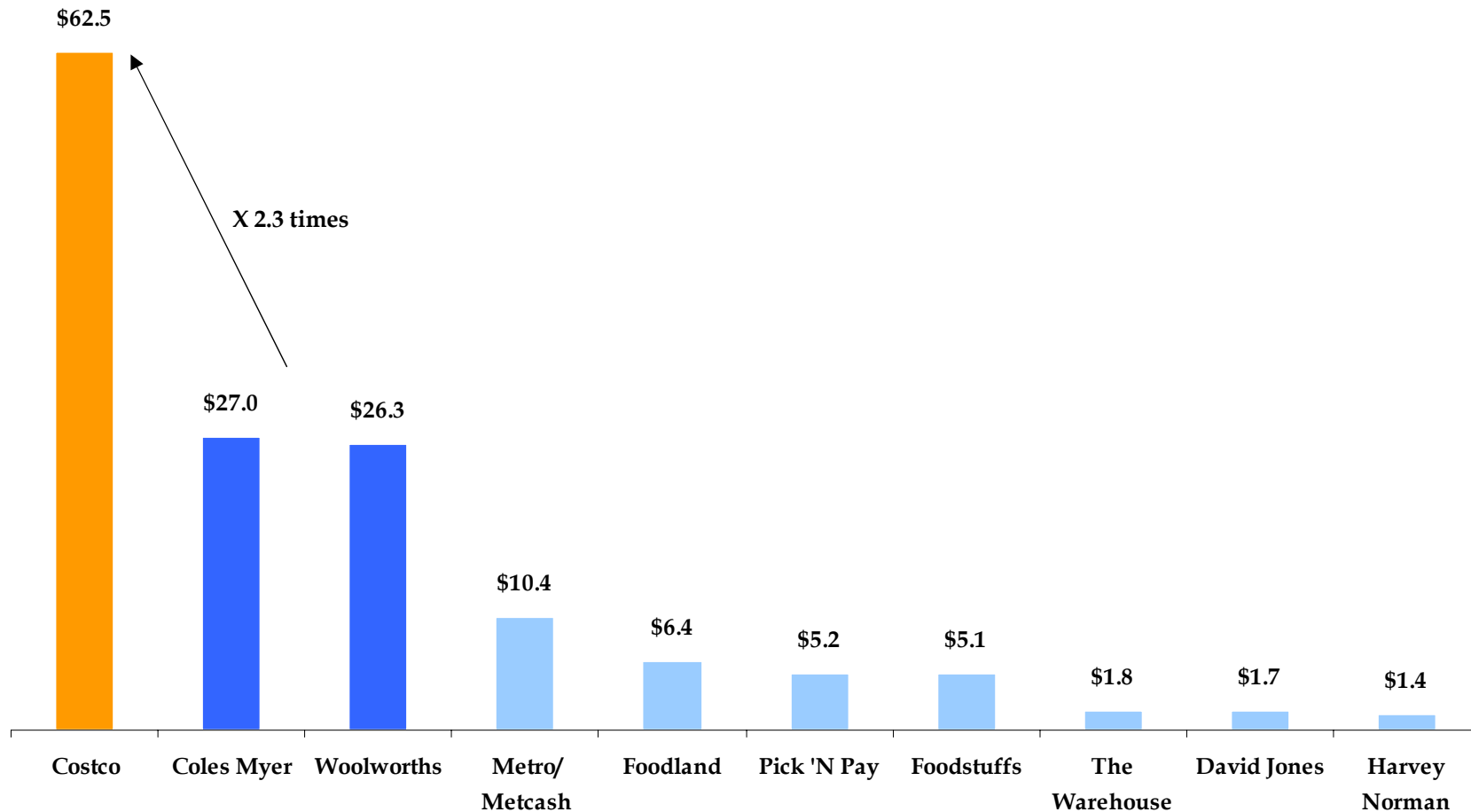
... and Costco executives visited Australia and New Zealand last year

- **“Three top executives from the multi-billion-dollar US discount retailer visited Auckland last weekend using a helicopter to investigate potential commercial sites in Auckland. They had also been viewing potential sites in Sydney and Melbourne.”** *The Independent, February 2003*
- **“We are looking at lots of different countries all over Asia and Europe... We hadn't been to Australia and NZ before so we wanted to have a look before we sifted through our options... Australia is one of several countries under examination for international expansion... Any decision is six to 12 months away, or even more.”** *Jeffrey Brotman, Chairman, Costco, February 2003*
- **“The chairman of US warehouse club operation Costco, Jeffrey Brotman, has confirmed that Australia is one of several countries under examination for international expansion. This follows reports of top Costco executives investigating potential sites in both Australia and New Zealand last weekend. Any expansion by Costco into Australia would raise the heat even more for domestic giants Coles and Woolworths, which collectively hold about three-quarters of the grocery market, but are under pressure from German discounter Aldi, with some evidence of a resurgence by the independent sector.”** *Just Food, February 2003*
- **“Most of the analysts will tell you that a business like that needs a population of at least one million per store which means just one store in New Zealand at the moment. It's just not economic to open a business like that. Even if they opened two stores or used Australia as a distribution centre, the economics don't work for such a low number. You need a whole lot of infrastructure to run a business like that.”** *Greg Muir, CEO, The Warehouse, February 2003*
- **“I would have thought it highly unlikely that Costco would consider investing at the moment in a market such as New Zealand... the country does not have sufficient density of population to interest a bulk retailer such as Costco. It would be a very unlikely circumstance that someone would try and start from scratch.”** *Trevor Coates, Managing Director, FAL, February 2003*

RELATIVE SIZE

Costco is 2.3 times the size of either Coles Myer or Woolworths based on total turnover

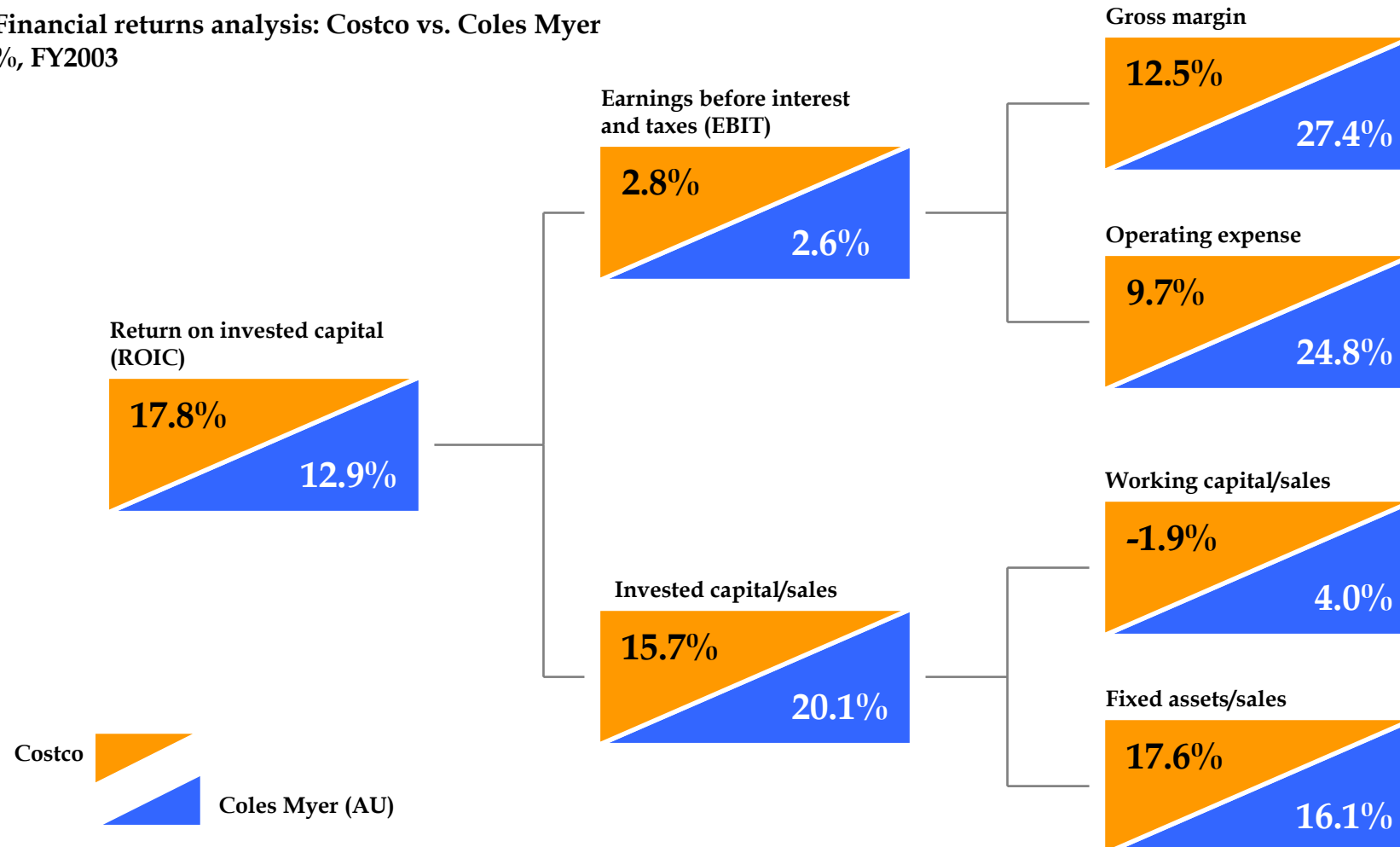
Relative total global sales comparison by major Australasian retailing group
A\$, billions, FY2003



FINANCIAL RETURNS: COSTCO VS. COLES MYER

Costco achieves higher returns on lower margins than (for example) Coles Myer

Financial returns analysis: Costco vs. Coles Myer
%, FY2003



PROPOSITION THREE

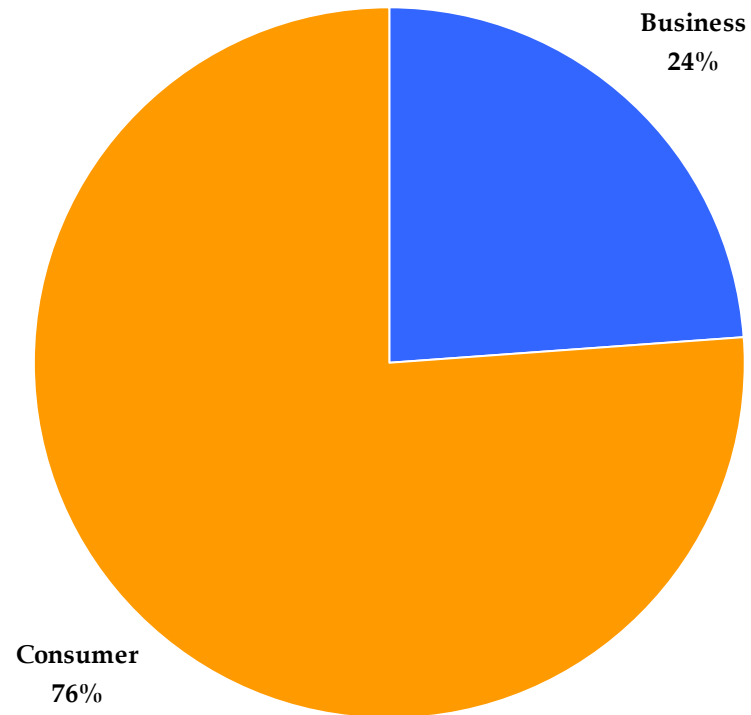
3. There is a large pool of likely Costco customers

- **Consumers account for 76% of memberships, while businesses account for 24% of membership**
- **While businesses account for only 24% of membership, they account for 60% of sales, however it is estimated that 50% of business sales are for household use**
- **Small business customers form the loyal core of the Costco customer base**
- **Foodservice, traditional cash & carry customers and small businesses make up a large part of Costco's business membership**
- **In Australia, there are 1.16 million potential small businesses customers for Costco**
- **Eighty-five percent of heavy wholesale club shoppers are from the upper income groups**
- **In Australia, Costco has a clear target market in the top 20% of Australian households that account for 39% of all household expenditure**

PERCENT OF MEMBERSHIP BY TYPE

Consumers account for 76% of memberships, while businesses account for 24% of membership

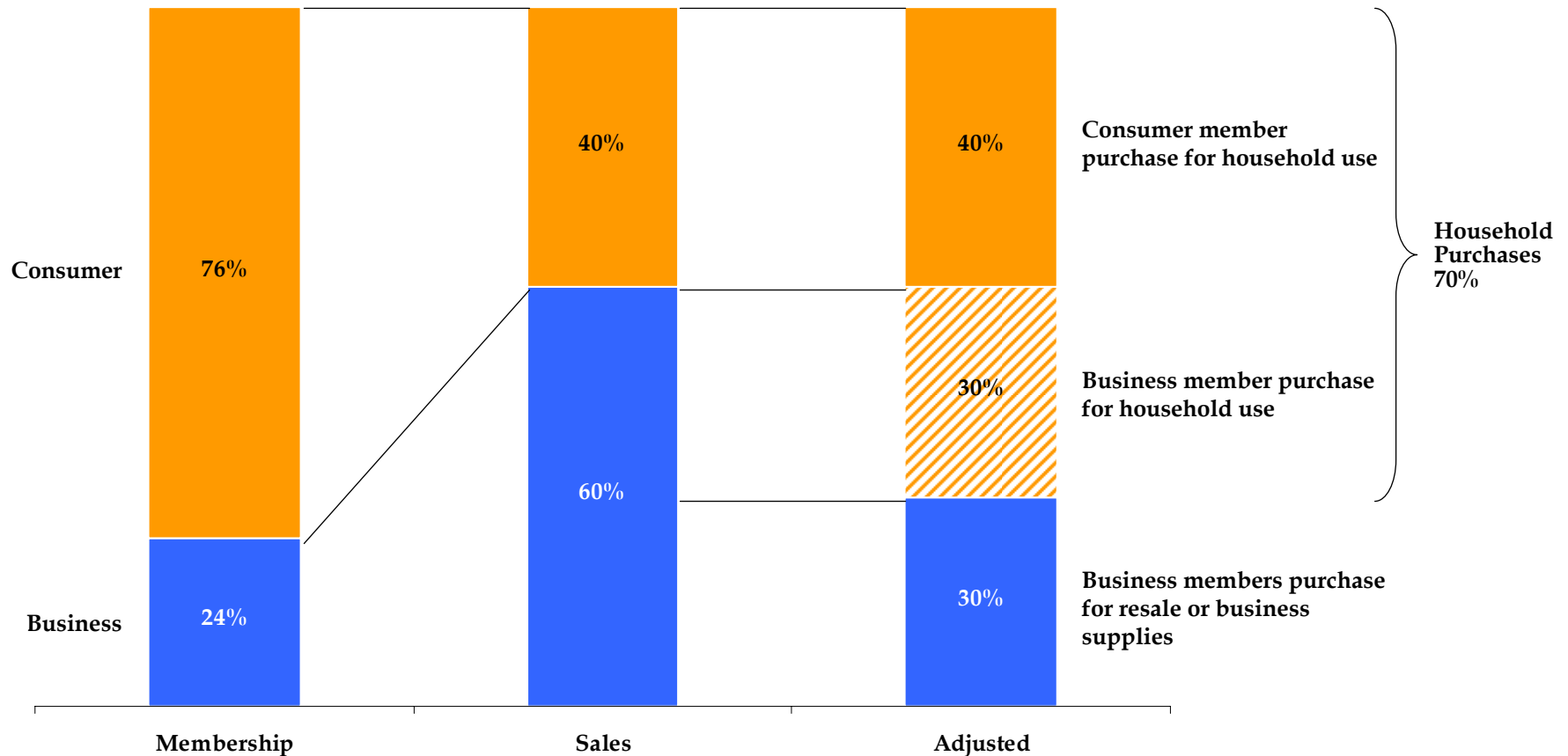
Costco membership numbers by type
%, members, 2003



RELATIVE IMPORTANCE

While businesses account for only 24% of membership, they account for 60% of sales, however it is estimated that 50% of business sales are for household use

Breakdown of membership by number and share of sales
%, 2003



SMALL BUSINESSES FORM THE CORE

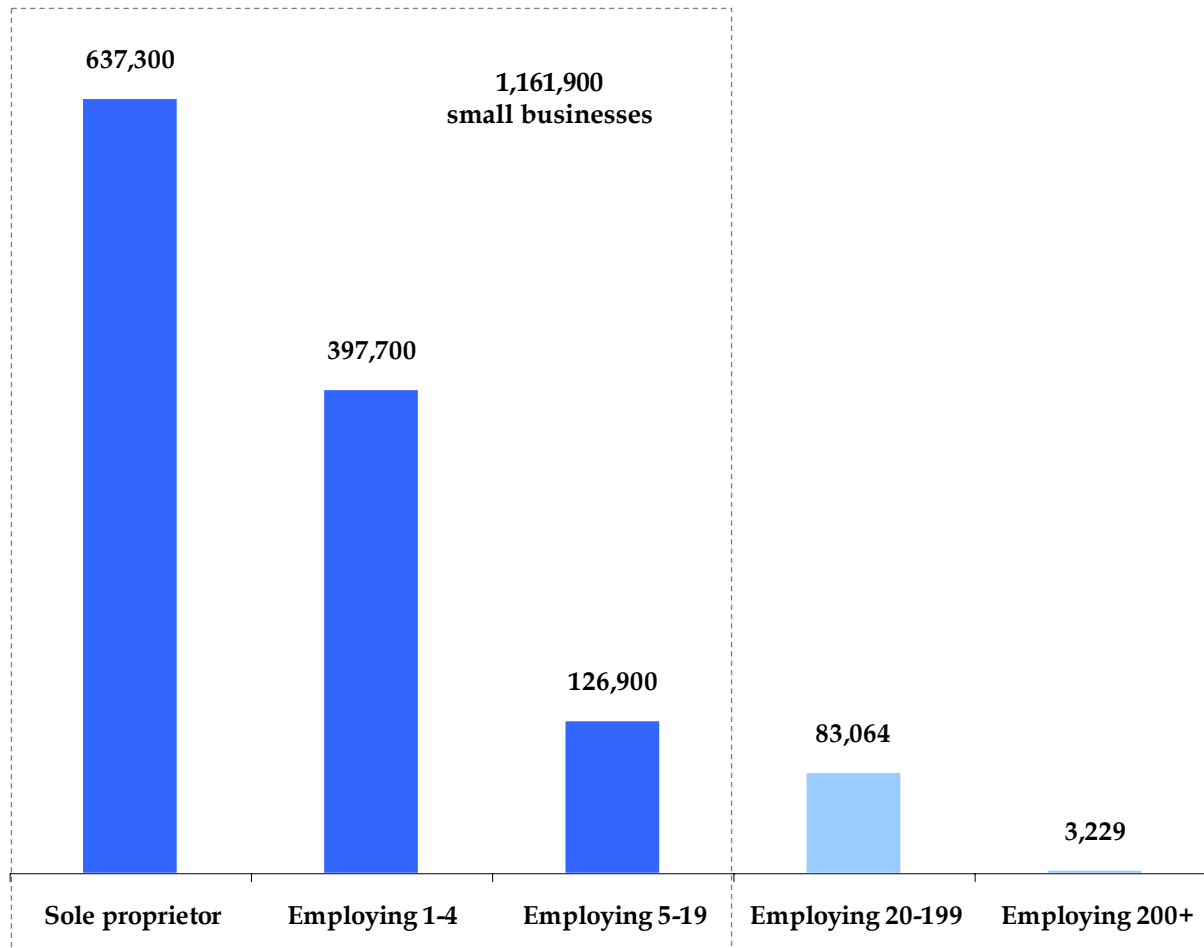
Small business customers form the loyal core of the Costco customer base

- **"We are operating businesses that are both retail and wholesale. From the beginning, our concept was to provide a cash and carry warehouse where business people who need something less than a truckload of merchandise can buy what they need conveniently and economically. At the same time, it seemed logical to offer the same convenience and value to qualified retail customers, who are willing to shop like wholesale customers without the service, breadth of product selection, and credit terms offered by most retail stores. Why should there be a difference between retail and wholesale? The powers that be have fixed in our minds that retail and wholesale should be different. In some cases, it's just one more step in increasing the cost. If a wholesaler is performing a real function, fine. But in many instances he's not, so why should there be an additional charge in there?"** *Sol Price, founder, Price Club, November 1990*
- **"Wholesaling is the reason for being of this concept. Retail is just the icing of the cake."** *Mervyn Weich, President, BJ's Wholesale Club, February 1985*
- **"Price Club stays ahead the competition by paying particular attention to serving our members. We also focus very heavily on our business members and satisfying their needs."** *Brent Knudson, VP Marketing, Price Club, November 1988*
- **"The business customers are very important for us. That's why we're as restrictive as we are. We don't want to drive those customers away."** *Jim Sinegal, CEO, Costco, Dec 1990*
- **"What we are filling is a classic market void, one abandoned by the large distributors of food, office supplies, auto supplies and so on. And I believe that our strength and permanence lies in the wholesale part of the business... What people forget is that the vast majority of sales are at wholesale."** *Jeffrey Brotman, Chairman, Costco, September 1985*

COSTCO BUSINESS TARGET MARKET IN AUSTRALIA

In Australia, there are 1.16 million potential small businesses customers for Costco

Number of businesses in Australia by number of employees
#, actual, 2001



TEN MOST COMMON BUSINESS MEMBERS

Foodservice, traditional cash & carry customers and small businesses make up a large part of Costco's business membership

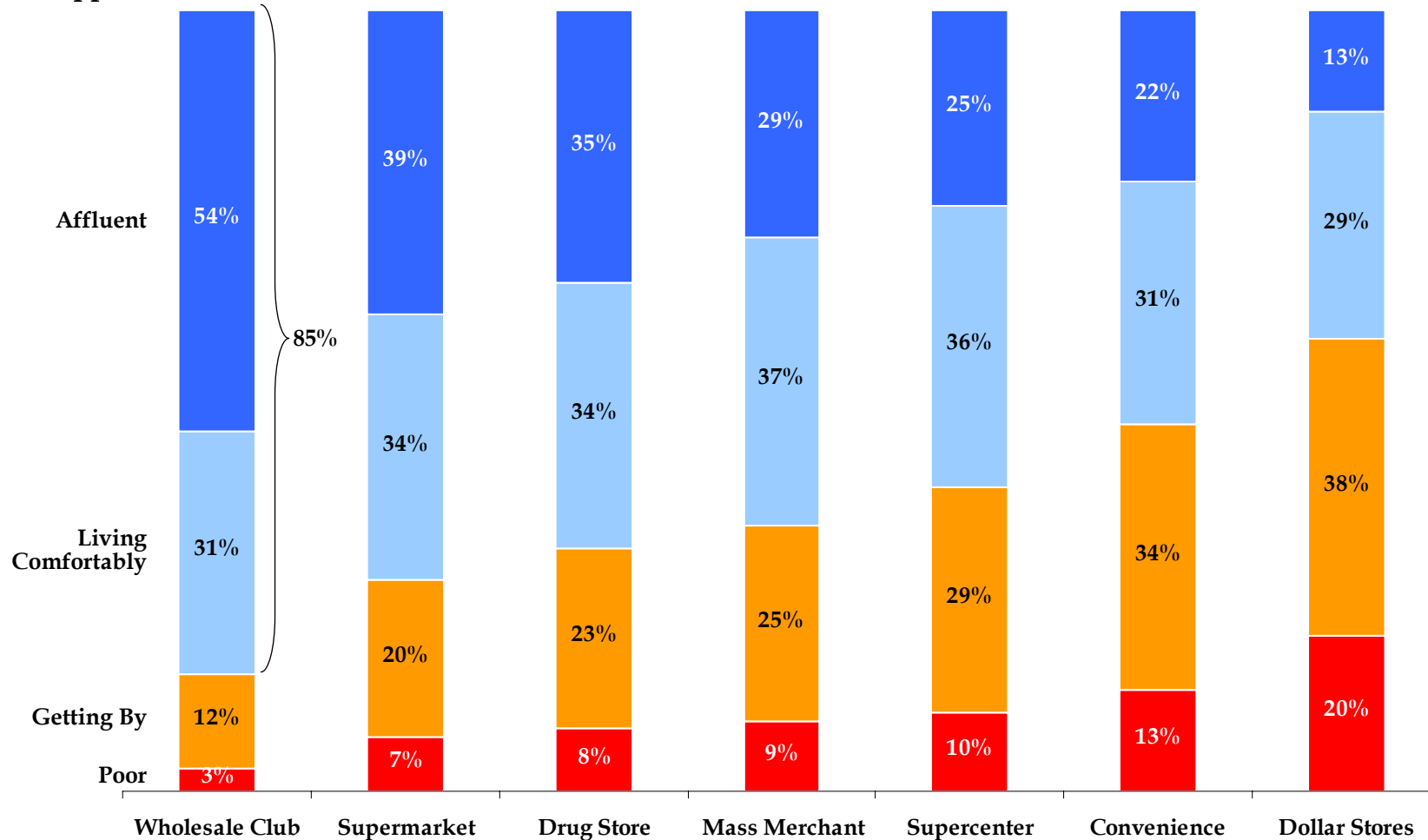
Ten most common business members by type
Ranking, 2003

1. Restaurants
2. Vending
3. Gas Stations
4. Day Care Centers
5. Convenience Stores or Small Grocers
6. Professionals (Doctors, Lawyers)
7. Hotels & Motels
8. Hair Salons
9. Caterers
10. Construction

WHOLESALE CLUB DEMOGRAPHICS - INCOME

In the United States, eighty-five percent of heavy wholesale club shoppers are from the upper income groups

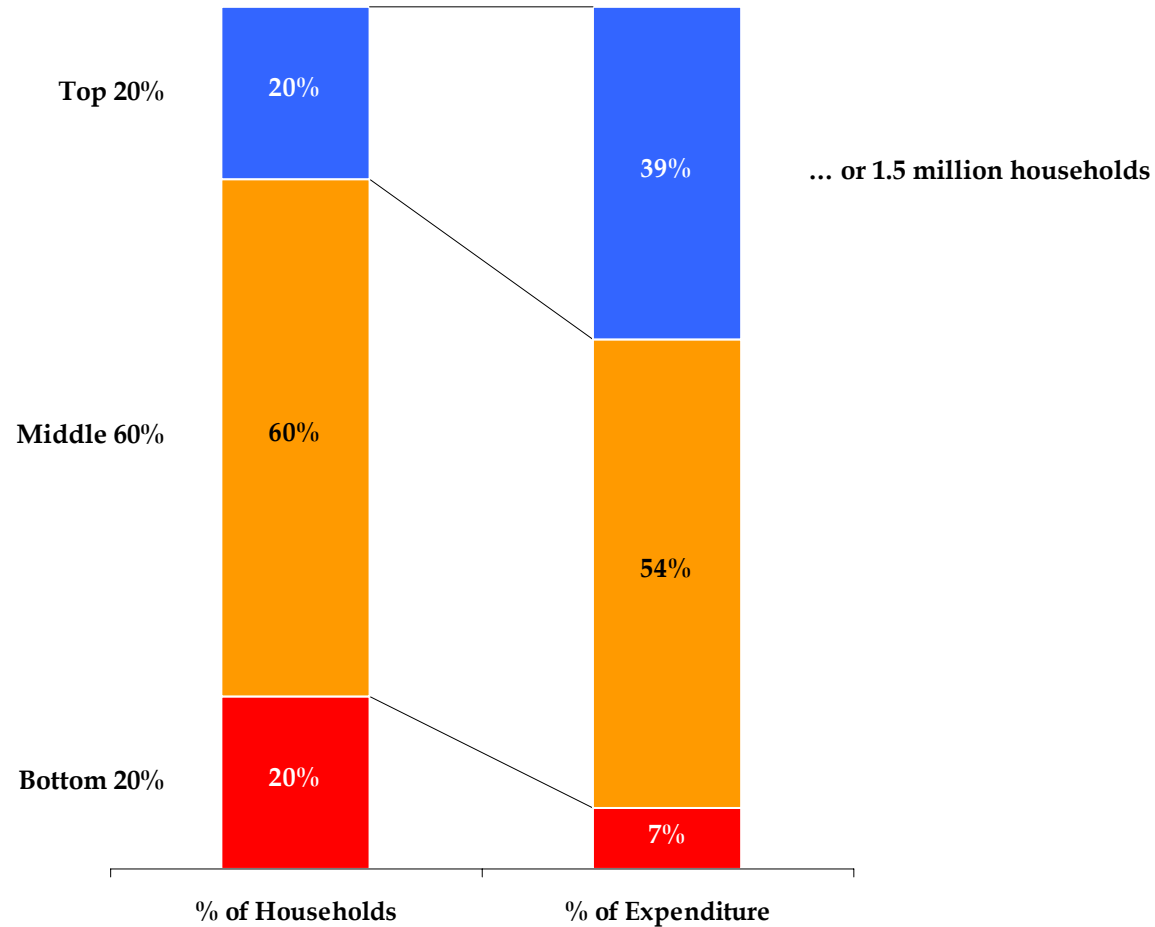
Comparative demographics of heavy shoppers by income by store format in the US market
% of shoppers, 52we 2002.12.28



COSTCO CONSUMER TARGET MARKET IN AUSTRALIA

In Australia, Costco has a clear target market in the top 20% of Australian households that account for 39% of all household expenditure

Australian households by quintile and share of household expenditure
%, 2002



PROPOSITION FOUR

4. Costco will become a small but significant player in the market

- **Store Density**
 - **The US market suggests that 350,000 people per warehouse club is a reasonable density assumption for Australasia; however, other countries suggest 500,000 per outlet may be more realistic**
 - **At these density assumptions the Australasian market could support between forty and sixty outlets**
 - **If the concept reaches 350,000 people per unit, the outlets would be distributed as follows**

- **Canadian Model**
 - **We project strong Costco unit growth over the next ten years, based on the early experience of Costco in the Canadian market**
 - **In numerous ways Canada provides a good model for the potential of Costco in Australasia**

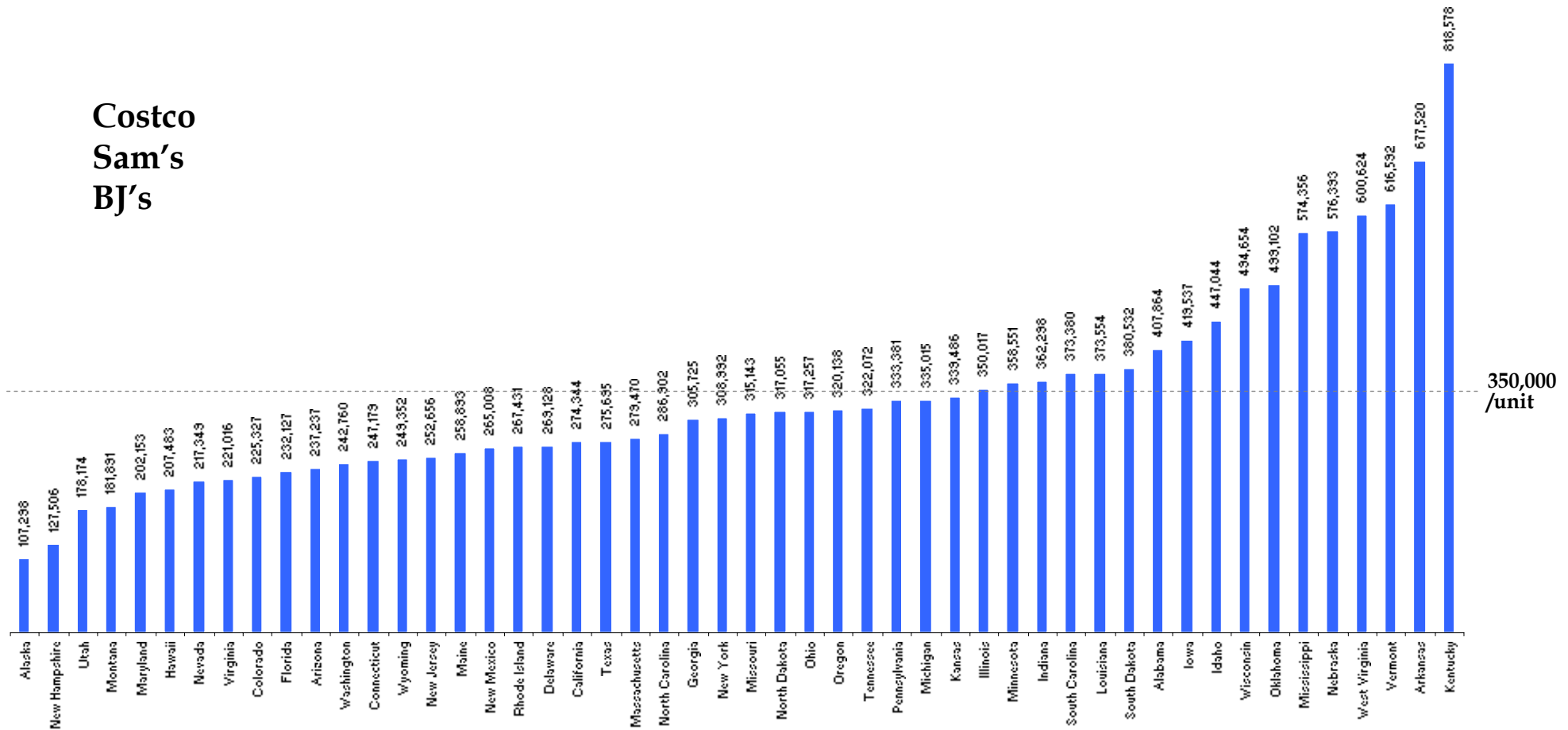
- **Sales and Market Share**
 - **We project Costco growing to A\$3.7 billion in sales by 2014**
 - **We project Costco will become a small but significant player in the Australasian market**

POPULATION PER WAREHOUSE CLUB IN THE US

The US market suggests that 350,000 people per warehouse club is a reasonable density... assumption for Australasia

Population per warehouse club in US states
People, thousands

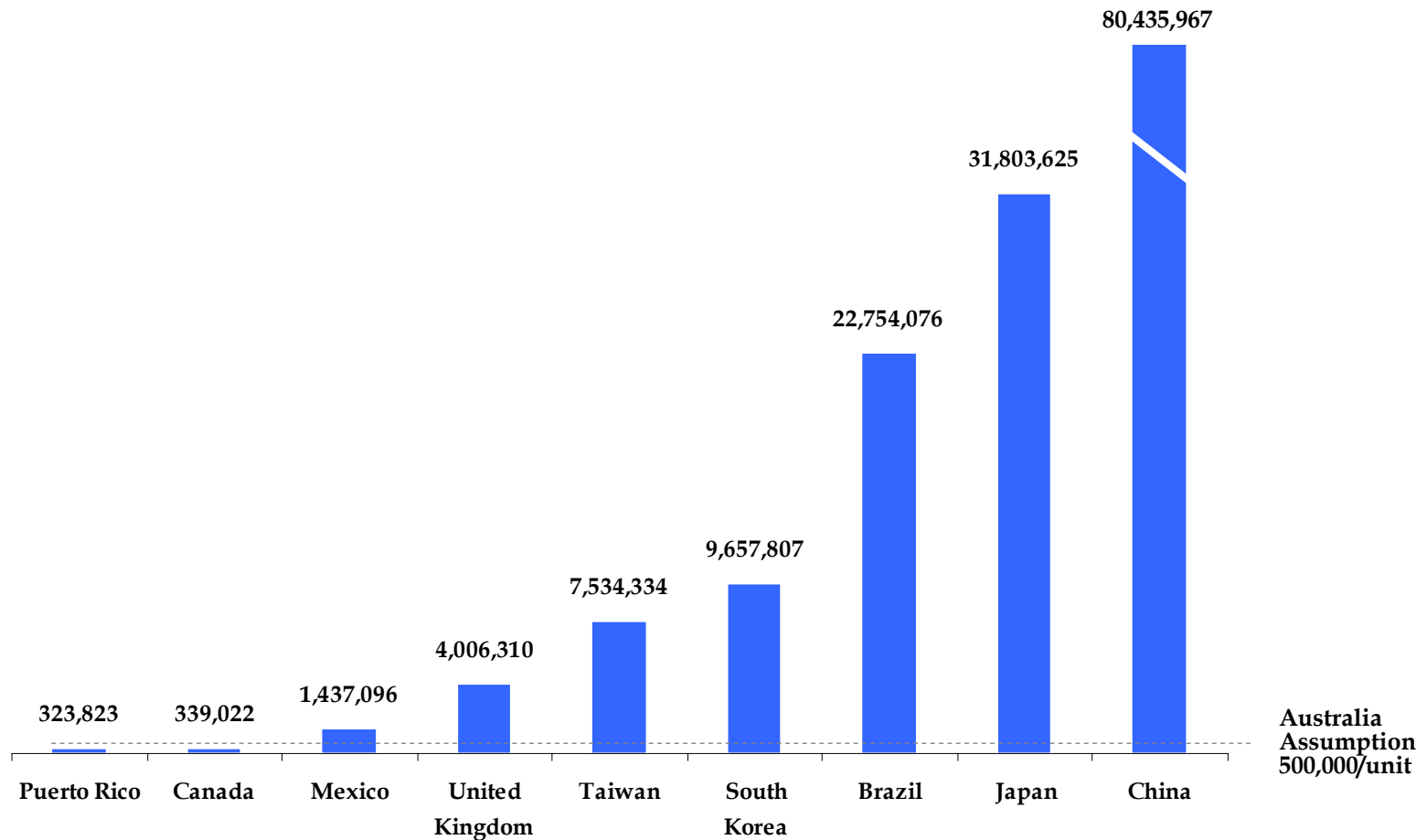
Costco
Sam's
BJ's



POPULATION PER WAREHOUSE CLUB BY COUNTRY

... however, other countries suggest 500,000 per outlet may be more realistic

Population per warehouse club in select countries
People, actual



POTENTIAL UNITS

At these density assumptions the Australasian market could support between forty and sixty outlets

Potential Costco outlets in Australasia based on different density assumptions

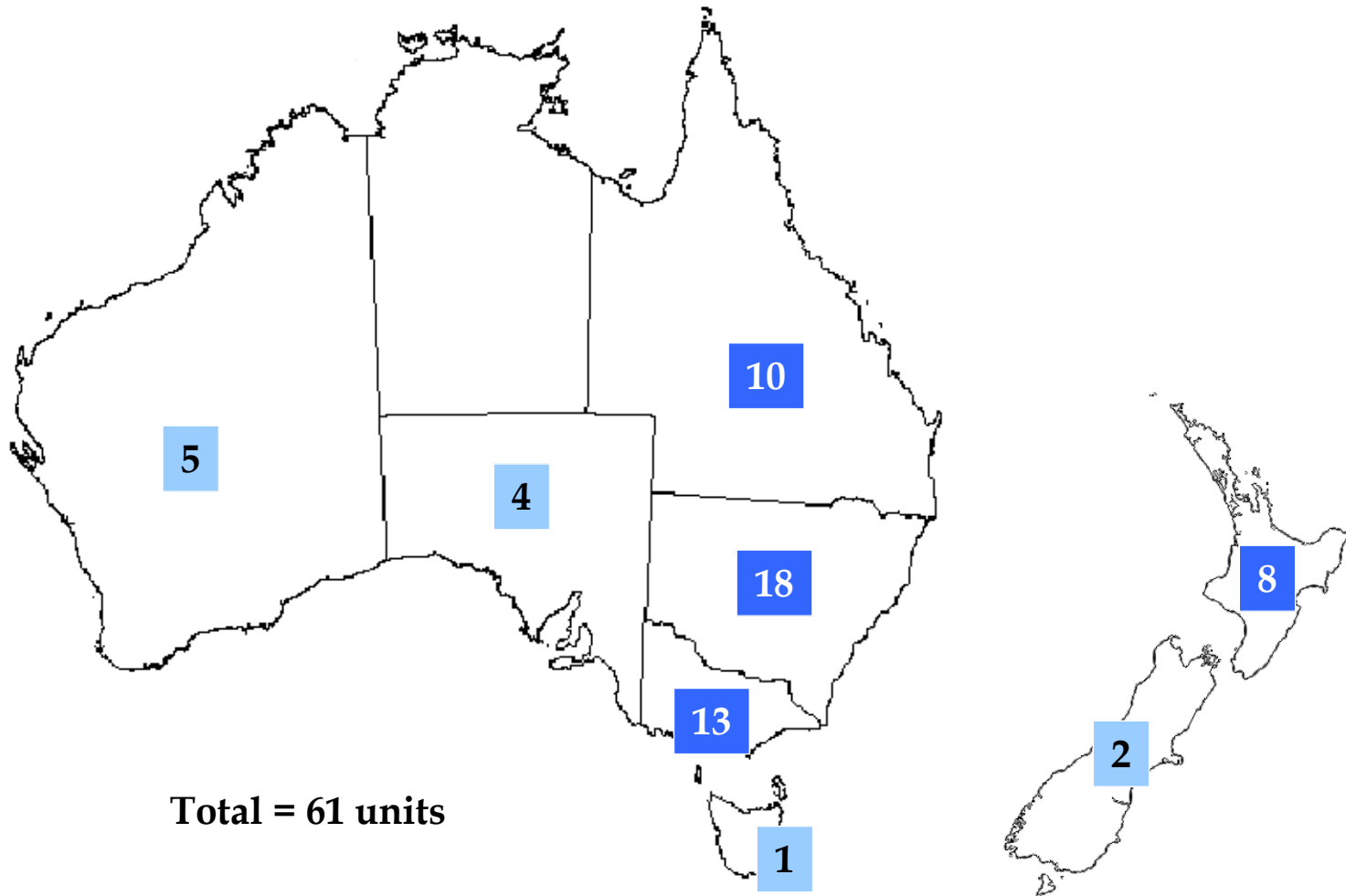
People, thousands, units, actual

	State Population	Population per Costco			
		1,000,000	500,000	350,000	250,000
New South Wales	6,640,000	6	13	18	26
Victoria	4,873,000	4	9	13	19
Queensland	3,707,000	3	7	10	14
North Island	3,048,000	3	6	8	12
Western Australia	1,927,000	1	3	5	7
South Australia	1,520,000	1	3	4	6
South Island	962,000	0	1	2	3
Tasmania	473,000	-	-	1	1
ACT	322,000	-	-	-	1
Northern Territory	198,000	-	-	-	-
Implied Total		18	42	61	89

POTENTIAL LOCATIONS

If the concept reaches 350,000 people per unit, the outlets would be distributed as follows

Potential Costco outlets in Australasia by state at 350,000 per outlet
Units, potential

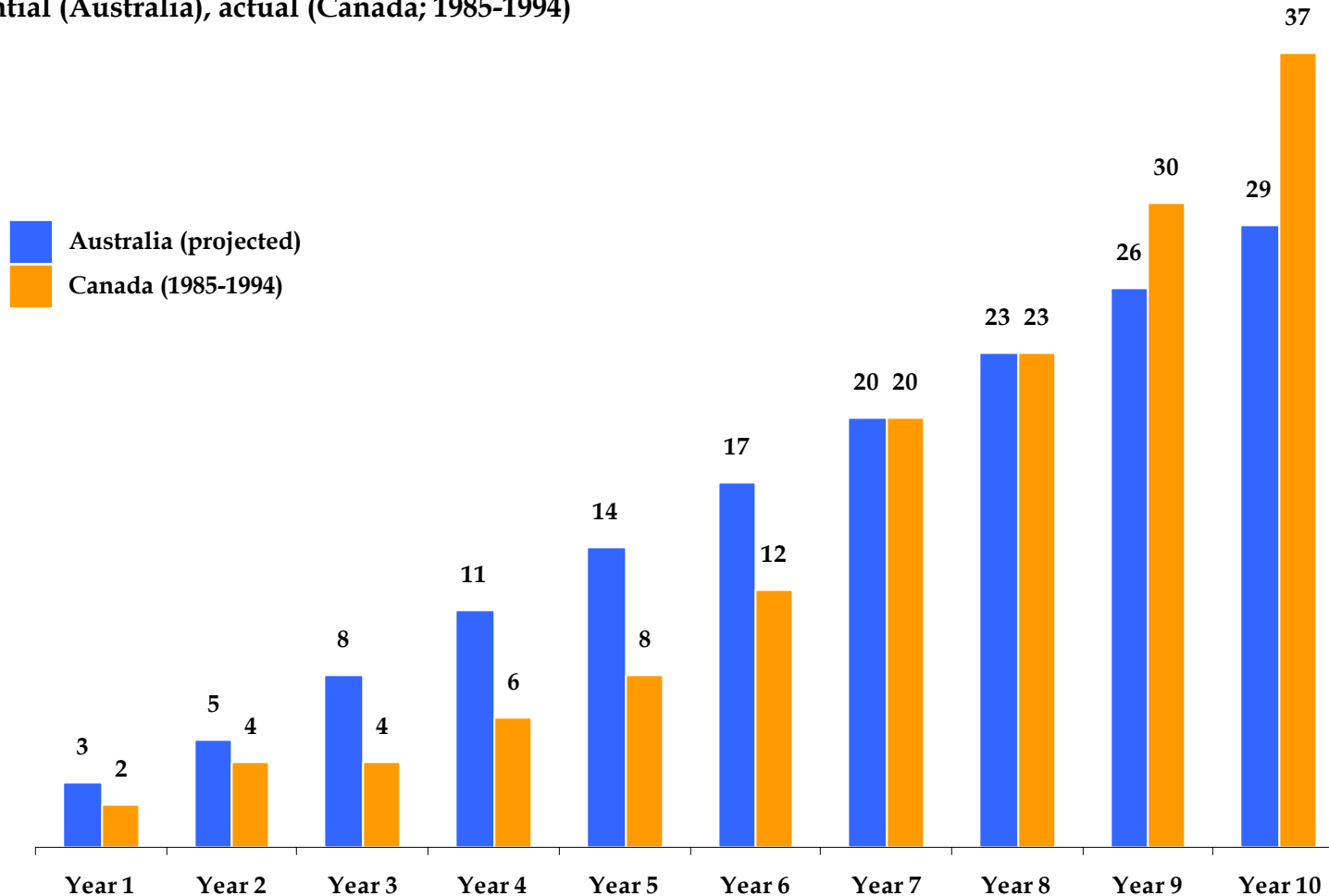


Total = 61 units

PROJECTED UNIT GROWTH VS. HISTORICAL CANADA

We project strong Costco unit growth over the next ten years, based on the early experience of Costco in the Canadian market

Projected Costco outlets in Australasia vs historical Canadian outlets by year
 Units, potential (Australia), actual (Canada; 1985-1994)



CANADA IS A GOOD MODEL

In numerous ways Canada provides a good model for the potential of Costco in Australasia

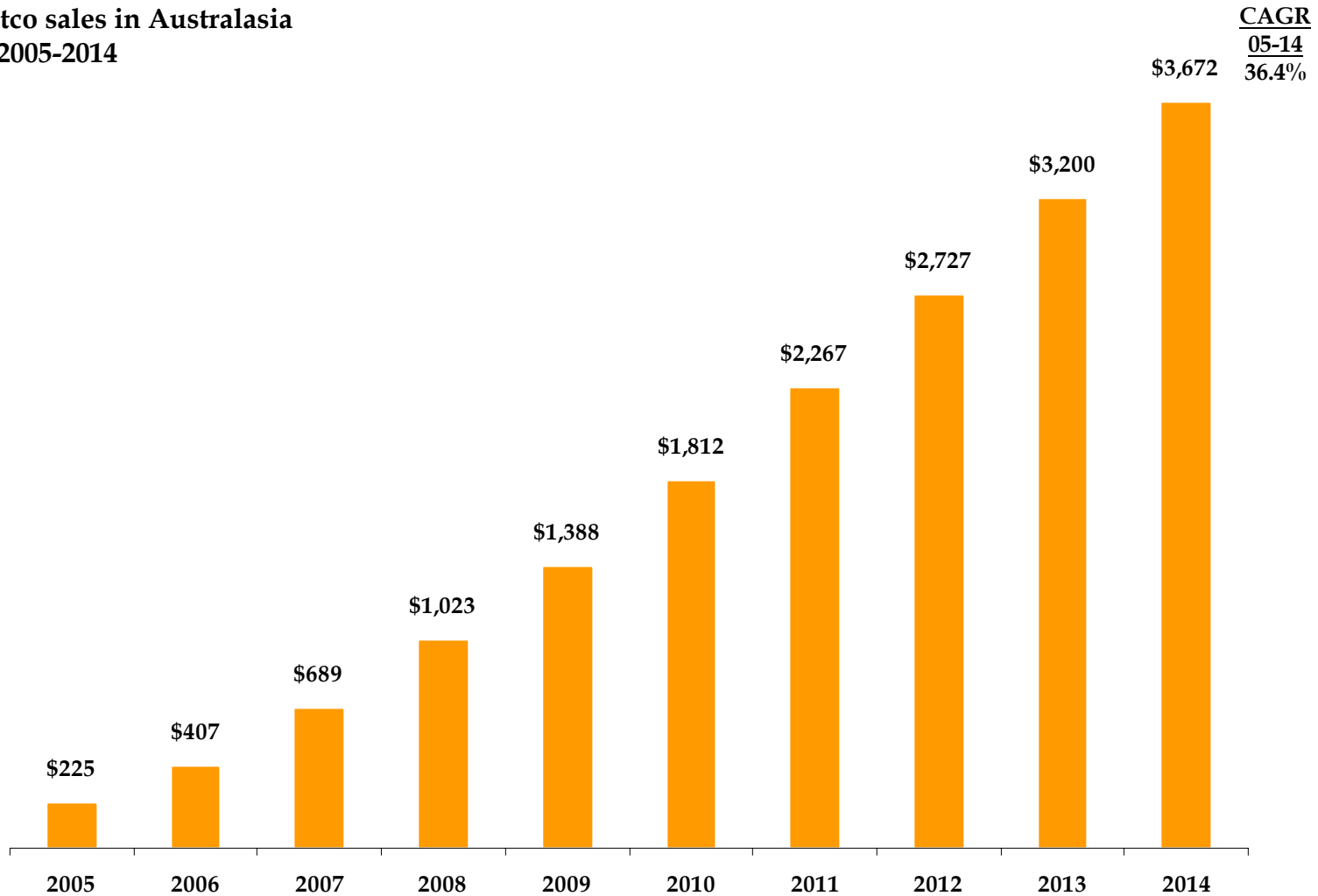
Population and Costco units: current Canadian province vs. projected Australasian state
 Units, actual (Canada; 2003), potential (Australia; 2020)

Canada 2003	Population	% of Population	Actual Costco Units (2003)	Australia 2020	Population	% of Population	Projected Costco Units (2020)
Ontario	12.3m	39%	21	New South Wales	6.7m	28%	18
Quebec	7.5m	24%	15	Victoria	4.9m	21%	13
British Columbia	4.2m	12%	11	Queensland	3.8m	16%	10
Alberta	3.2m	10%	8	North Island	3.0m	13%	8
Manitoba	1.2m	4%	2	Western Australia	1.9m	8%	5
Saskatchewan	1.0m	3%	2	South Australia	1.5m	6%	4
Nova Scotia	0.9m	3%	1	South Island	1.0m	4%	2
New Brunswick	0.8m	2%	1	Tasmania	0.5m	2%	1
Newfoundland	0.5m	2%	1	ACT	0.3m	1%	-
Northern Territories/ Yukon/PEI	0.2m	1%	-	Northern Territory	0.2m	1%	-
	31.7m	100%	62		23.8m	100%	61

PROJECTED SALES

We project Costco growing to A\$3.7 billion in sales by 2014

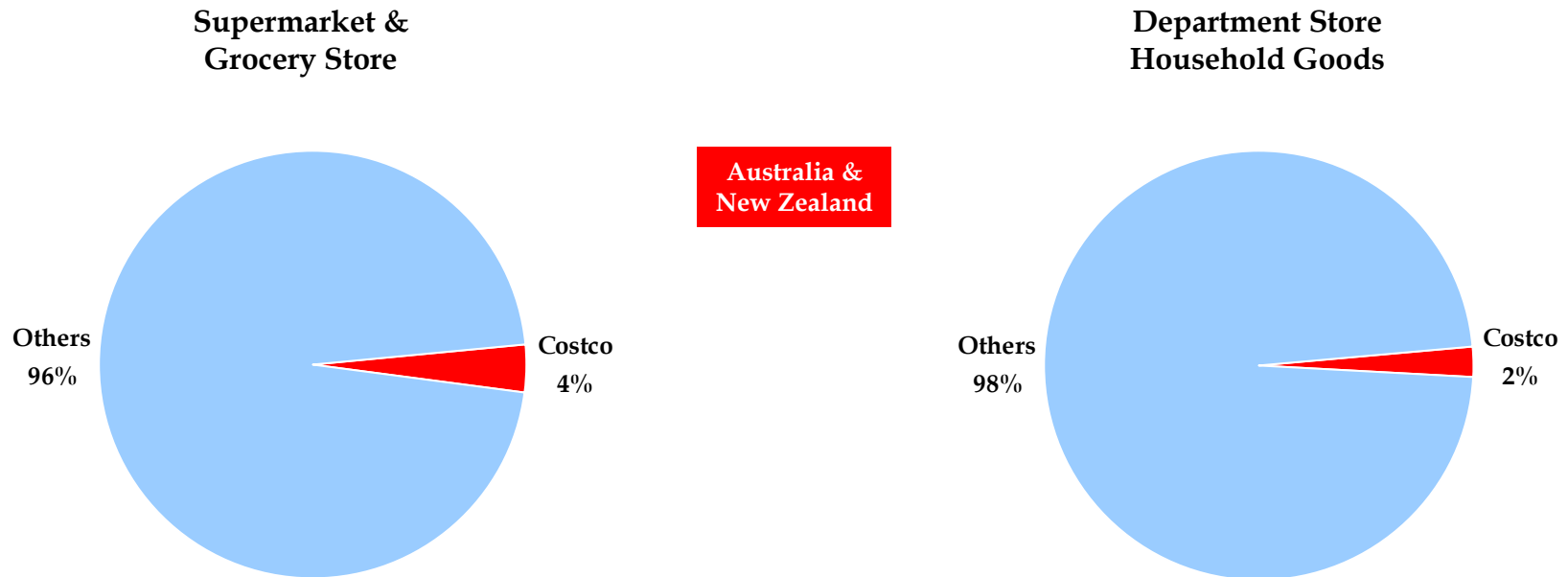
Projected Costco sales in Australasia
A\$, millions, 2005-2014



MARKET SHARE

We project Costco will become a small but significant player in the Australasian market

Projected Costco market share in Australasia by 2014
A\$, Billions, % of sales, 2014



PROPOSITION FIVE

5. Costco will have a diffuse effect spread across a number of different channels

- In the United States, Costco has a limited impact across a wide range of channels
- We estimate the impact of Costco will be felt across supermarket, general merchandise and service-related channels
- We project that eighty percent of Costco's impact will be felt by Cash & Carry Wholesalers, Supermarkets, and Department Stores
- Cash & Carry Impact
 - Costco is more efficient and offers lower prices than traditional cash & carry operators
 - Metcash's Campbell's Cash & Carry will bear the initial brunt of Costco's arrival
- Supermarket Impact
 - Costco will have a limited impact on existing supermarket groups
 - Best Case: Costco has achieved an eight percent supermarket market share in the Seattle metro market, where it was founded and where it has been in operation for twenty years
 - Worst Case: Costco has struggled to achieve one percent grocery market share in the United Kingdom where it has been for eleven years
 - Supermarket groups will fight with suppliers over the low prices being offered at Costco
 - Following retailers in the other countries, Australasian supermarket groups will respond to the arrival of Costco in one of four ways
- Department Store Impact
 - Costco will just be another contributor to the long slow death of the department store in Australasia

LIMITED IMPACT ACROSS A RANGE OF CHANNELS

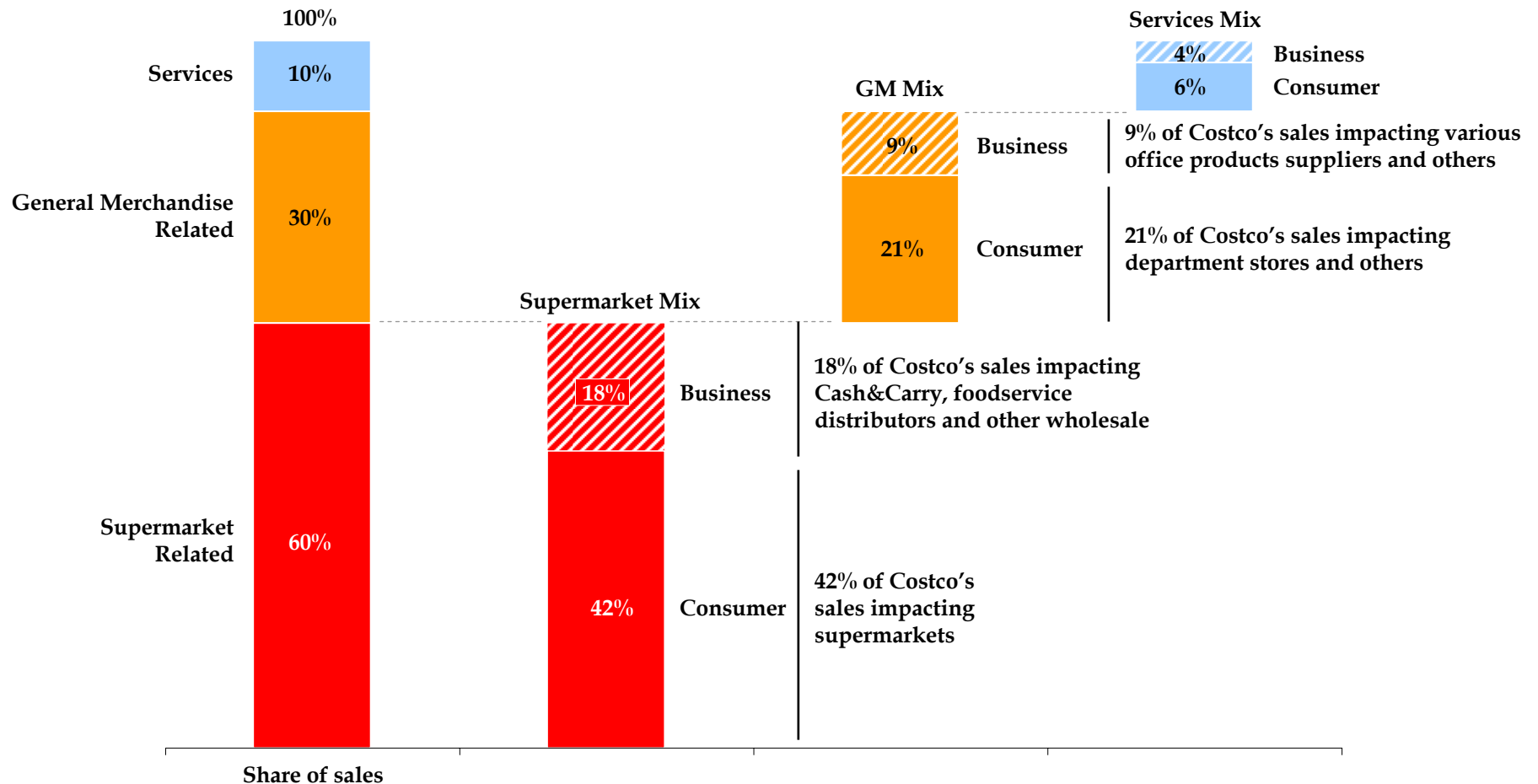
In the United States, Costco has a limited impact across a wide range of channels

- **"We're just too widespread in categories and narrow in content to make any impact. We have a nibbling effect on other retailers... We probably won't push anyone out of business. However, we may be the straw that breaks the camel's back for some inefficient distributors."** *Jeffrey Brotman, Chairman, Costco, September 1985*
- **"The warehouse club is not a substitute for the grocery store or the general merchandise outlet. Our selection is far too limited for that."** *John Geisse, Chairman and founder, The Wholesale Club, November 1983*
- **"The good news, from our view, is that it has come out of everybody's a little bit, both traditional supermarkets and various other category-dominant retailers, as well as, traditional retailers. I'm sitting here wearing a very high quality, basic black sock that I bought for \$10.99 for four pair... So some of that business is supplanting business that I may have done at the local mall. Then, there's fresh foods. Now a \$3 billion-plus business for us, fresh foods has been a big driver of frequency. And, our pharmacy business, a \$1 billion-plus business for us, has continued to grow, as well, both prescription and over the counter."** *Richard Galanti, CFO, Costco, September 2001*

ESTIMATING COSTCO IMPACT BY CHANNEL

We estimate the impact of Costco will be felt across supermarket, general merchandise and service-related channels

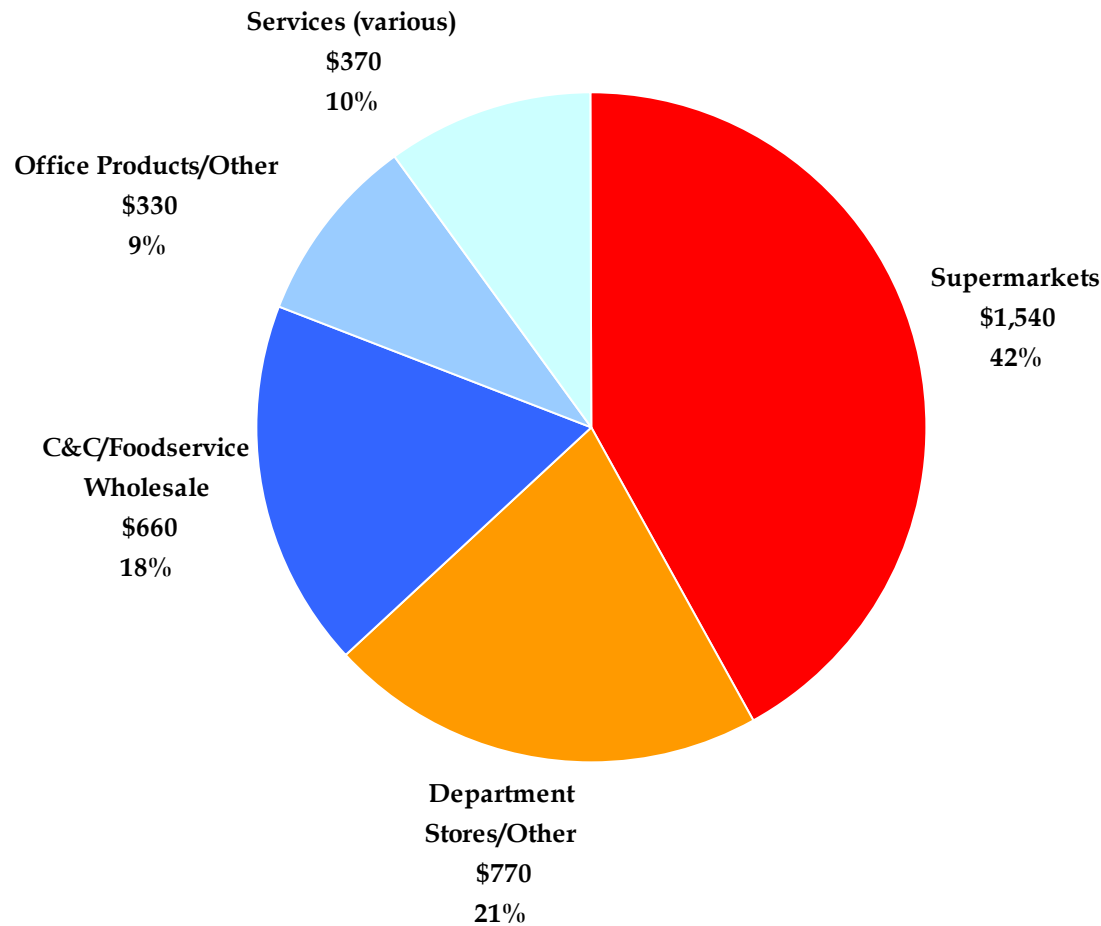
Division of Costco sales into likely areas of impact
% of sales, model



COSTCO IMPACT BY CHANNEL

We project that eighty percent of Costco's impact will be felt by Cash & Carry Wholesalers, Supermarkets, and Department Stores

Impact of Costco by channel 10 years after opening in Australasia
 % of sales, model, 2014



MORE EFFICIENT THAN CONVENTIONAL CASH & CARRY







Costco is more efficient and offers lower prices than traditional cash & carry operators

- **“Price was 59 when he was ousted from Fedmart. He took to strolling through San Diego, chatting with grocery store owners, restaurateurs, the people who ran the newspaper and candy stands. He discovered a gap in the retail marketing network, just waiting to be filled. At the time, owners of small businesses could either deal with four or five wholesalers or they could go to cash-and-carry operations with limited stock and pay higher prices. Price was convinced that if he could keep prices down and yet put everything a small business customer needed under one roof, he’d have a winning formula.”** *New York Times, December 1988*
- **“The brilliance of the concept lies in Sol Price's recognition that by combining a discount retail venture with a format that exploits weaknesses in wholesaling, he could generate unheard of sales and reap all of the benefits and economies that go with that kind of volume. The wholesale customer is important, but so is the retail customer, because in most markets there simply are not enough businesses to generate enough volume. That is one reason why warehouses in the Price Company mold can succeed in a trade area with about 18,000 potential business customers, while an operation like Cincinnati-based Makro, which serves only wholesale customers, has said it looks for markets with 50,000 potential business members per warehouse.”** *Chain Store Age, February 1985*
- **“What makes the concept successful is not that it's wholesaling or retailing. It's new kind of distribution system, the most efficient kind there is in getting certain types of products into the hands of those who want them.”** *Henry Haimsohn, President, Pace Membership Warehouse, February 1985*
- **“We compete with both wholesalers and retailers. This is a very specialized type of business, we are not trying to replace all competitors. We only want to serve those that don't want all the services; it's an opportunity for the businessman. There is no way on a consistent basis you can buy cheaper elsewhere, because our margins and overhead are lower.”** *Jeffrey Brotman, Chairman, Costco, February 1985*

MAJOR AUSTRALASIAN CASH & CARRY OPERATORS

Metcash's Campbells Cash & Carry will bear the initial brunt of Costco's arrival

Major Australasian cash and carry operators
various, 2003-2004

Fascia	Parent	# of units	# of sku	C&C Sales (\$m; 2003)	Sales/unit (\$m; 2003)	Regions of operation
	Metcash	41	12,000	A\$947.1m	A\$23.1m	Eastern Australia (NSW, QLD, VIC, SA, NT)
	FAL	3	12,000	A\$131.6	A\$53.9m	Western Australia
	Statewide Independent Wholesalers	3	15,000	n/a	n/a	Tasmania
	Foodstuffs Auckland	10	16,000	NZ\$300m	NZ\$30m	Auckland region of New Zealand
	Foodstuffs Wellington	7	12,000+	NZ\$100m	NZ\$15m	Lower North Island of New Zealand
	Foodstuffs South Island	7	12,000+	NZ\$100m	NZ\$15m	South Island of New Zealand
-	Moore Wilsons	4	12,000+	NZ\$60m	NZ\$15m	Wellington region of New Zealand

LIMITED IMPACT ON EXISTING SUPERMARKET

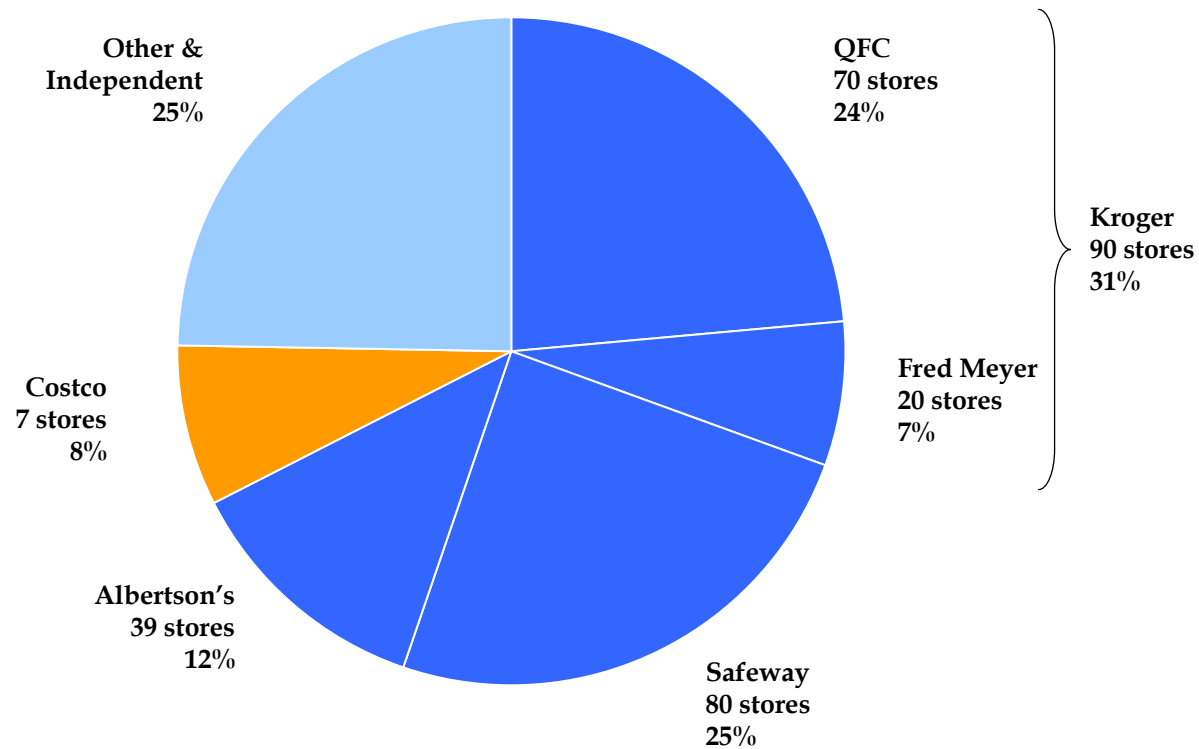
Costco will have a limited impact on existing supermarket groups

- **"I read an interesting statement by the president of Safeway, who noted that when a Price Club opens across the street from a Safeway, that particular market's volume goes up. But citywide, Safeway's volume in multiple stores goes down about half a point." *Jeffrey Brotman, Chairman, Costco, September 1985***
- **"There's only so much business out there, so they'll end up taking some of it away from supermarkets. How much is hard to pinpoint. They're not a totally known entity. They haven't really been a force up here yet. But they probably will be. And we and our competitors will have to reckon with that." *James Demme, President, Shaw's Supermarkets, Sept 1989***
- **"Warehouse clubs pose a threat, but not an overwhelming one. They're starting to put in a lot of food and sundry items found in supermarkets and the price savings can be amazing. But supermarkets win out on convenience. They offer a much greater variety of items than clubs do, and they're much more accessible to shoppers. Clubs draw from a very wide geographic perimeter. Clubs will take some of the market away, but any supermarket that's strong will be able to weather the competition." *Susan Spielberg, analyst, Shearson Lehman, September 1989***
- **"There are a lot of things warehouse clubs can't and won't do... Their entry into a marketplace simply means you become a better operator and do a better job, as a supermarket, of fulfilling your customers' needs." *Tom Courthouse, Vice President, Riverside Markets, September 1989***
- **"Food in a warehouse club format is a volume-seeking strategy... The top warehouse club operators have increased their food assortments mainly as a way to capture higher traffic count... I think warehouse club stores are a threat to supermarkets, but on the other hand, they don't seem to be putting any out of business." *Steve Mandel, analyst, Goldman Sachs, May 1989***
- **"Costco is a survivor in an industry soon to be littered with casualties. Costco operates in a much larger sandbox than most investors appreciate... Costco is already the 6th or 7th largest grocery retailer... We believe the company is well positioned to take share from overpriced, high-overhead channels of distribution - such as traditional grocery chains." *Janice Hofferber, analyst, Fulcrum, October 2002***

COSTCO BEST CASE - SEATTLE METRO

Costco has achieved an eight percent supermarket market share in the Seattle metro market, where it was founded and where it has been in operation for twenty years

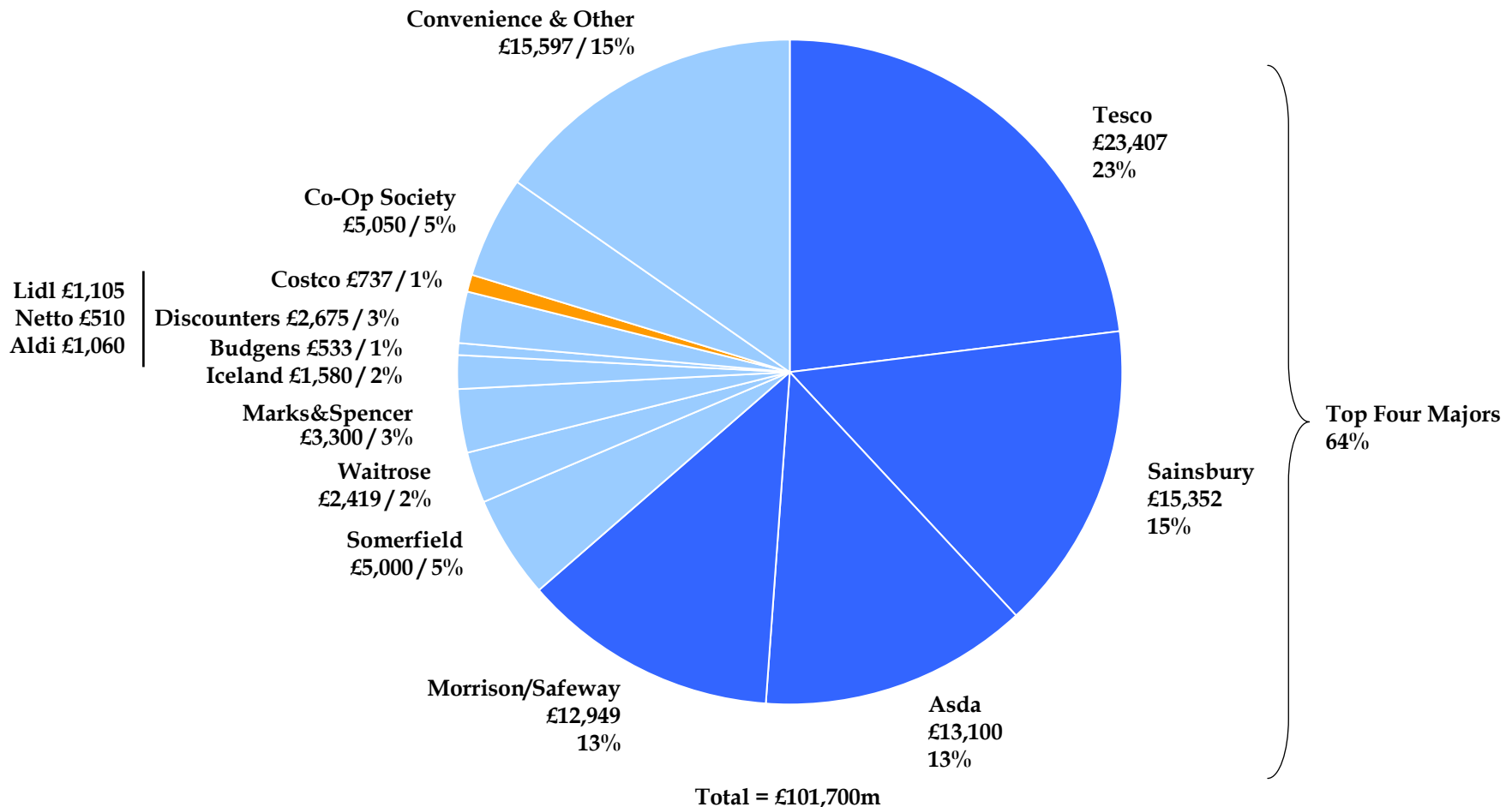
Supermarket market share by chain in Seattle Metro (WA)
Units, percent of sales, 2003



COSTCO WORST CASE - UNITED KINGDOM

Costco has struggled to achieve one percent grocery market share in the United Kingdom where it has been for eleven years

Food/Grocery retail market share by chain in the United Kingdom
percent of sales, 2003



SUPERMARKETS WILL FIGHT WITH SUPPLIERS

Supermarket groups will fight with suppliers over the low prices being offered at Costco

- **“Warehouse clubs are at the root of a bitter debate over discriminatory pricing policies. While the warehouse clubs' lower operating costs enable them to operate on an 11% gross margin - around half that required by the supermarkets - the supermarkets have also accused manufacturers of unfairly selling goods to the clubs at lower prices. The manufacturers deny this, saying that the price difference arises because the clubs take larger packs and do not insist on the promotional and slotting allowances demanded by the supermarkets... Over the last decade, warehouse clubs had grown from virtually nothing to sales of \$30bn and, although this was small compared with the supermarkets' sales of \$270bn, the rapid rise had caught the attention of retailers and wholesalers.”** *Tim Simmons, Editor, Supermarket News, April 1992*

POTENTIAL SUPERMARKET RESPONSE

Following retailers in the other countries, Australasian supermarket groups will respond to the arrival of Costco in one of four ways

Potential supermarket responses to Costco model

	Relative likelihood	International Role Model	Theoretical Australasian Example	Commentary
1. Ignore	Low	Most UK retailers	-	Probably the most logical response - WW/CML initially use Costco to weaken Metcash; unlikely as one will react and the other react to the reaction (<i>see arrival of Aldi</i>)
2. Launch store brand club-pack; stock in-line	High	Safeway, Albertsons, Others	Homebrand Club-Pack Toilet Paper	Attempt to address low prices on specific items by launching a sub-brands and stocking it in-line with the existing section; causes significant price erosion and cannibalisation
3. Launch store brand club-packs; create separate club section	Medium	Wegmans, Loblaws, Others	Pak'N Save Club-Pack Aisle	As above except retailer creates a separate signed section or wall-of-values for club-type merchandise; takes up lots of valuable space with very low margin lines
4. Launch own club store format	Low	Loblaws	Mega-Myer Warehouse Club	Longshot outside bet; Coles launches yet another format or Woolworths creates a joint-venture with Wal-Mart to bring Sam's Club to Australia

EXAMPLE: CLUB PACK SECTION AT LOBLAWS

Canadian retailer Loblaws offers a club-pack section in stores impacted by Costco or Sam's Club



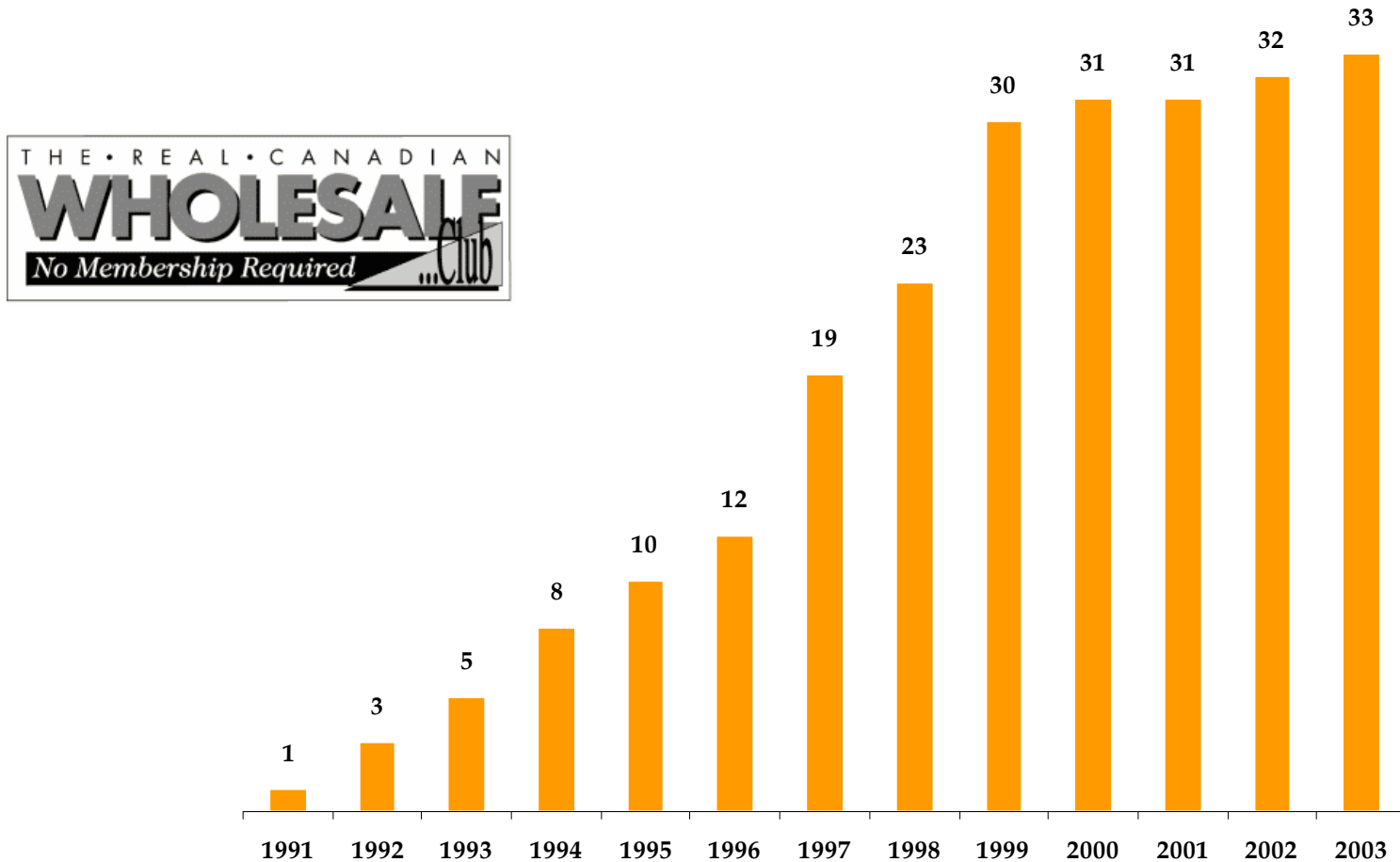
SUPERMARKET RESPONSE - CLUB PACKS

Australian and New Zealand supermarkets will launch club-packs at some point

- **“The various programs being pursued by supermarkets also include offering club-pack sizes as in-and-out merchandise and launching 'warehouse' sections within traditional supermarkets. The club-pack goods are sourced from manufacturers that already provide merchandise to membership warehouses and from private label suppliers that have started club-pack lines for supermarkets. The underlying theme of the supermarkets' merchandising to counter the clubs as evidenced in ads is that these retailers provide customers with goods at the same low prices as membership warehouses and therefore shoppers don't have any reason to shop the clubs. Supermarkets, however, so far haven't developed the low expense structure necessary to battle the clubs and the success of their current efforts is open to question.”** *DSN, March 1993*
- **“We have a 100-ft. section of grocery club packs across from the back wall. The club pack section includes 250 to 300 skus, selected by merchandisers on the basis of high movement and local preferences. Popular items include condiments, cooking oil, cereals, peanut butter and detergents. The meat section, meanwhile, is sprinkled with a selection of large-size family packs. And a massive grocery Wall of Values is the first sight that greets shoppers in most stores. If a club store opened across the street, we would love it, because it would generate traffic for us. In fact, we're now building a store in Tempe across from a Price Club, and next to a Wal-Mart.”** *Gary Rhymes, CFO, Megafoods Stores, January 1993*

EXAMPLE: GROWTH OF LOBLAWS “REAL CANADIAN WHOLESALE CLUB” UNITS
Loblaws also launched its own club store in 1991, which has grown to 33 units

Number of Real Canadian Wholesale Club units in Canada
 units, actual, 1991-2003



DEPARTMENT STORE/OTHER RETAIL IMPACT

Costco will just be another contributor to the long slow death of the department store in Australasia

- **"If department stores are the wife, we are the mistress." Sol Price, Founder, Price Club, December 1988**
- **"I always felt department stores and conventional retailers were doomed. They lived and died trying to take advantage of customers, and they were inefficient. The more I studied it, the more it seemed the cost of getting goods to consumers was way too high. I'm surprised the department store has survived this long." Sol Price, Founder, Price Club, November 2003**
- **"What's happened in the U.S. in the last few years is that K mart, Penney's, Sears have been upgrading and a classic void has appeared in market place and warehouses, even in modified form, will fill that void. It will be a change similar to the corner grocery store giving way to the supermarket. We're moving to an age of efficient operators and educated consumers. It's a customer-driven phenomenon. This also represents the grandest opportunity for the specialty department and specialty store. Not everyone wants to buy in a warehouse. Nordstrom's, headquartered in this city, has enjoyed great success because of its specialty focus." Jeffrey Brotman, Chairman, Costco, September 1985**
- **"In the beginning we didn't compete head on with anyone. We took bits of business from many types of stores from Sears to Saks... More recently office warehouses have become competition. We're living in a world with great diversity and that keeps us running." Sol Price, Founder, Price Club, Mar 1989**

PROPOSITION SIX

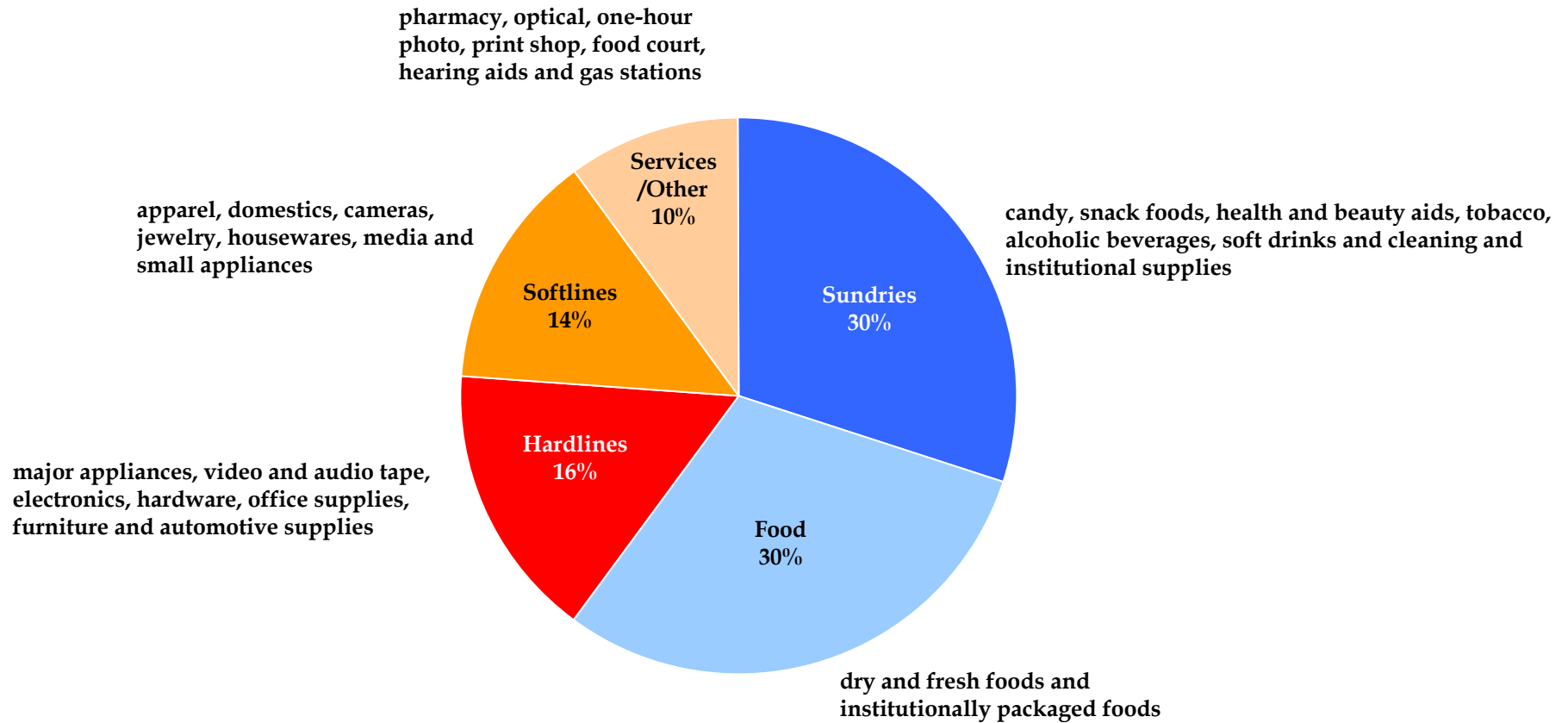
6. Manufacturers need to carefully consider the implications of Costco's market entry

- **Costco sells products across five main categories: sundries, food, hardlines, softlines, and services**
- **Once it reached scale, we project that Costco will have purchases of \$3.2 billion spread across only 4,000 sku**
- **Costco will change the underlying dynamics of the Australasian market in a number of important ways**

SALES BY CATEGORY

Costco sells products across five main categories: sundries, food, hardlines, softlines, and services

Costco percent of sales by category
%, 2003



SALES BY CATEGORY AT SCALE

Once it reached scale, we project that Costco will have purchases of \$3.2 billion spread across only 4,000 sku

Projected Costco sales and purchases by category
 %, A\$; millions; 2014

Category	% of sales	Sales (A\$m; 2014)	Purchases (A\$m; 2014)
Sundries	30%	\$1,102m	\$970m
Food	30%	\$1,102m	\$970m
Hardgoods	16%	\$588m	\$515m
Softgoods	14%	\$514m	\$450m
Services	10%	\$367m	\$320m
		\$3,672	\$3,225m

} \$2,905m / 4,000 sku = \$726,250/sku/year

MANUFACTURER IMPLICATIONS

Costco will change the underlying dynamics of the Australasian market in a number of important ways

Situation and likely impact of Costco market entry

Situation	Implications	Sample comment
Costco buys large volumes of consumer packaged goods from major multinationals	1. Costco will have a lower cost price on many products than either Woolworths or Coles	"They are selling it for less than we can buy it for."
	2. Costco will be able to bring more global pressure on manufacturers than local retailers	"Seattle is closer to Battle Creek than Sydney."
Costco buys on a global basis	1. Costco will expect to receive pricing unwarranted by its initial scale in Australasia	"We don't pay half that for it in the United States."
	2. Costco will initially import many non-perishable lines and may parallel import products with regional price variations	"They're buying it in Asia for the total group and bringing it in by the container."
	3. There will be some knock-on effect increased pricing pressure on local manufacturers and suppliers	"We've had to reduce our local advertising budget."
	4. Success with Costco on an Australasian basis will give local manufacturers an opportunity to sell to Costco in other countries	"We're now supplying all their Asian stores."
Costco offers products in large pack sizes	1. Price expectations on key lines will decline, especially those with significant foodservice demand	"Costco is really constraining our ability to increase the price of our olive oil."
	2. Demand patterns may shift as a result of both Costco's range and competitors club pack response	"We're selling a lot more 24 packs of toilet paper than we used to."
	3. Local manufacturers may need to reconfigure production capacity	"We've had to reconfigure line two to handle multi-packs."