

COSTCO WHOLESALE CORP /NEW
Form 10-Q
June 05, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

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

For the quarterly period ended May 11, 2014

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 offices) (Zip Code)

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

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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller company)

Smaller reporting company

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 May 28, 2014 was 438,295,696.

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PART I—FINANCIAL INFORMATION

Item 1—Financial Statements

COSTCO WHOLESALE CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

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

(unaudited)

| | May 11, 2014 | September 1, 2013 |
|---|-----------------|----------------------|
| ASSETS | | |
| CURRENT ASSETS | | |
| Cash and cash equivalents | \$5,736 | \$4,644 |
| Short-term investments | 1,539 | 1,480 |
| Receivables, net | 1,115 | 1,201 |
| Merchandise inventories | 8,483 | 7,894 |
| Deferred income taxes and other current assets | 660 | 621 |
| Total current assets | 17,533 | 15,840 |
| PROPERTY AND EQUIPMENT | | |
| Land | 4,632 | 4,409 |
| Buildings and improvements | 12,212 | 11,556 |
| Equipment and fixtures | 4,808 | 4,472 |
| Construction in progress | 615 | 585 |
| | 22,267 | 21,022 |
| Less accumulated depreciation and amortization | (7,684 |) (7,141 |
| Net property and equipment | 14,583 | 13,881 |
| OTHER ASSETS | | |
| | 585 | 562 |
| TOTAL ASSETS | \$32,701 | \$30,283 |
| LIABILITIES AND EQUITY | | |
| CURRENT LIABILITIES | | |
| Accounts payable | \$8,361 | \$7,872 |
| Accrued salaries and benefits | 2,056 | 2,037 |
| Accrued member rewards | 764 | 710 |
| Accrued sales and other taxes | 474 | 382 |
| Deferred membership fees | 1,297 | 1,167 |
| Other current liabilities | 1,735 | 1,089 |
| Total current liabilities | 14,687 | 13,257 |
| LONG-TERM DEBT, excluding current portion | 4,985 | 4,998 |
| DEFERRED INCOME TAXES AND OTHER LIABILITIES | 1,008 | 1,016 |
| Total liabilities | 20,680 | 19,271 |
| COMMITMENTS AND CONTINGENCIES | | |
| EQUITY | | |
| Preferred stock \$.005 par value; 100,000,000 shares authorized; no shares issued and outstanding | 0 | 0 |
| Common stock \$.005 par value; 900,000,000 shares authorized; 438,582,000 and 436,839,000 shares issued and outstanding | 2 | 2 |
| Additional paid-in capital | 4,835 | 4,670 |
| Accumulated other comprehensive loss | (69 |) (122 |
| Retained earnings | 7,051 | 6,283 |
| Total Costco stockholders' equity | 11,819 | 10,833 |

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| | | |
|------------------------------|----------|----------|
| Noncontrolling interests | 202 | 179 |
| Total equity | 12,021 | 11,012 |
| TOTAL LIABILITIES AND EQUITY | \$32,701 | \$30,283 |

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

(amounts in millions, except per share data)

(unaudited)

| | 12 Weeks Ended | | 36 Weeks Ended | |
|---|-----------------|-----------------|-----------------|-----------------|
| | May 11, 2014 | May 12, 2013 | May 11, 2014 | May 12, 2013 |
| REVENUE | | | | |
| Net sales | \$25,233 | \$23,552 | \$75,457 | \$71,099 |
| Membership fees | 561 | 531 | 1,660 | 1,570 |
| Total revenue | 25,794 | 24,083 | 77,117 | 72,669 |
| OPERATING EXPENSES | | | | |
| Merchandise costs | 22,554 | 21,038 | 67,421 | 63,530 |
| Selling, general and administrative | 2,487 | 2,313 | 7,519 | 7,006 |
| Preopening expenses | 16 | 10 | 48 | 34 |
| Operating income | 737 | 722 | 2,129 | 2,099 |
| OTHER INCOME (EXPENSE) | | | | |
| Interest expense | (25 |) (25 |) (78 |) (63 |
| Interest income and other, net | 12 | 15 | 60 | 61 |
| INCOME BEFORE INCOME TAXES | 724 | 712 | 2,111 | 2,097 |
| Provision for income taxes | 245 | 248 | 728 | 658 |
| Net income including noncontrolling interests | 479 | 464 | 1,383 | 1,439 |
| Net income attributable to noncontrolling interests | (6 |) (5 |) (22 |) (17 |
| NET INCOME ATTRIBUTABLE TO COSTCO | \$473 | \$459 | \$1,361 | \$1,422 |
| NET INCOME PER COMMON SHARE | | | | |
| ATTRIBUTABLE TO COSTCO: | | | | |
| Basic | \$1.08 | \$1.05 | \$3.10 | \$3.27 |
| Diluted | \$1.07 | \$1.04 | \$3.07 | \$3.23 |
| Shares used in calculation (000's) | | | | |
| Basic | 439,446 | 436,488 | 439,058 | 435,293 |
| Diluted | 442,720 | 440,780 | 442,651 | 439,738 |
| CASH DIVIDENDS DECLARED PER COMMON SHARE | \$0.355 | \$0.31 | \$0.975 | \$7.86 |

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

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COSTCO WHOLESALE CORPORATION
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(amounts in millions)

(unaudited)

| | 12 Weeks Ended | | 36 Weeks Ended | | |
|--|-----------------|-----------------|-----------------|-----------------|---|
| | May 11, 2014 | May 12, 2013 | May 11, 2014 | May 12, 2013 | |
| NET INCOME INCLUDING NONCONTROLLING INTERESTS | \$479 | \$464 | \$1,383 | \$1,439 | |
| Foreign-currency translation adjustment and other, net | 90 | (31 |) 54 | (74 |) |
| Comprehensive income | 569 | 433 | 1,437 | 1,365 | |
| Less: Comprehensive income attributable to noncontrolling interests | 8 | 4 | 23 | 18 | |
| COMPREHENSIVE INCOME ATTRIBUTABLE TO COSTCO | \$561 | \$429 | \$1,414 | \$1,347 | |

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

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COSTCO WHOLESALE CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(amounts in millions)
(unaudited)

| | 36 Weeks Ended | |
|--|-----------------|-----------------|
| | May 11, 2014 | May 12, 2013 |
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net income including noncontrolling interests | \$1,383 | \$1,439 |
| Adjustments to reconcile net income including noncontrolling interests to net cash provided by operating activities: | | |
| Depreciation and amortization | 708 | 651 |
| Stock-based compensation | 251 | 210 |
| Excess tax benefits on stock-based awards | (75) | (58) |
| Other non-cash operating activities, net | 19 | (7) |
| Deferred income taxes | (2) | 15 |
| Changes in operating assets and liabilities: | | |
| Increase in merchandise inventories | (584) | (595) |
| Increase in accounts payable | 603 | 638 |
| Other operating assets and liabilities, net | 839 | 581 |
| Net cash provided by operating activities | 3,142 | 2,874 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Purchases of short-term investments | (1,856) | (1,637) |
| Maturities and sales of short-term investments | 1,800 | 1,890 |
| Additions to property and equipment | (1,426) | (1,379) |
| Other investing activities, net | (5) | 10 |
| Net cash used in investing activities | (1,487) | (1,116) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Change in bank checks outstanding | (74) | (81) |
| Repayments of short-term borrowings | (15) | (230) |
| Proceeds from short-term borrowings | 59 | 293 |
| Proceeds from issuance of long-term debt | 0 | 3,610 |
| Distribution to noncontrolling interests | 0 | (22) |
| Proceeds from exercise of stock options | 22 | 47 |
| Minimum tax withholdings on stock-based awards | (164) | (120) |
| Excess tax benefits on stock-based awards | 75 | 58 |
| Repurchases of common stock | (171) | (36) |
| Cash dividend payments | (273) | (3,289) |
| Other financing activities, net | (1) | (14) |
| Net cash (used in) provided by financing activities | (542) | 216 |
| EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS | (21) | (54) |
| Net increase in cash and cash equivalents | 1,092 | 1,920 |
| CASH AND CASH EQUIVALENTS BEGINNING OF YEAR | 4,644 | 3,528 |
| CASH AND CASH EQUIVALENTS END OF PERIOD | \$5,736 | \$5,448 |
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION: | | |
| Cash paid during the first thirty-six weeks of year for: | | |
| Interest (reduced by \$8 and \$10 interest capitalized in 2014 and 2013, respectively) | \$85 | \$64 |

| | | |
|---|-------|-------|
| Income taxes, net | \$299 | \$491 |
| SUPPLEMENTAL DISCLOSURE OF NON-CASH FINANCING ACTIVITIES: | | |
| Cash dividend declared, but not yet paid | \$156 | \$135 |

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

(amounts in millions, except share data and warehouse number data)

(unaudited)

Note 1—Summary of Significant Accounting Policies

Description of Business

Costco Wholesale Corporation (Costco or the Company), a Washington corporation, and its subsidiaries operate membership warehouses based on the concept that offering members low prices on a limited selection of branded and select private-label products in a wide range of merchandise categories will produce high sales volumes and rapid inventory turnover. At May 11, 2014, Costco operated 653 warehouses worldwide: 464 United States (U.S.) locations (in 43 states, Washington, D.C., and Puerto Rico), 87 Canada locations, 33 Mexico locations, 25 United Kingdom (U.K.) locations, 19 Japan locations, 10 Taiwan locations, 10 Korea locations, and 5 Australia locations. The Company's online business operates websites in the U.S., Canada, U.K., and Mexico.

Basis of Presentation

The condensed consolidated financial statements include the accounts of Costco, its wholly-owned subsidiaries, subsidiaries in which it has a controlling interest, and consolidated entities in which it has made equity investments or has other interests through which it has majority-voting control or it exercises the right to direct the activities that most significantly impact the entity's performance. The Company reports noncontrolling interests in consolidated entities as a component of equity separate from the Company's equity. All material inter-company transactions between and among the Company and its consolidated subsidiaries and other consolidated entities have been eliminated in consolidation. The Company's net income excludes income attributable to noncontrolling interests in Taiwan and Korea. Unless otherwise noted, references to net income relate to net income attributable to Costco.

These 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 that 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 (U.S. GAAP) 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 1, 2013.

Fiscal Year End

The Company operates on a 52/53 week fiscal year basis, with the fiscal year ending on the Sunday closest to August 31. References to the third quarters of 2014 and 2013 relate to the twelve-week fiscal quarters ended May 11, 2014, and May 12, 2013, respectively. References to the first thirty-six weeks of 2014 and 2013 relate to the thirty-six weeks ended May 11, 2014, and May 12, 2013, respectively.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP 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 and assumptions.

Reclassifications

Certain reclassifications have been made to prior fiscal year amounts or balances to conform to the presentation in the current fiscal year. These reclassifications did not have a material impact on the Company's previously reported condensed consolidated financial statements.

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Note 1—Summary of Significant Accounting Policies (Continued)

Fair Value of Financial Instruments

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

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is estimated by applying a fair value hierarchy, which requires maximizing the use of observable inputs when measuring fair value. The three levels of inputs are:

Level 1: Quoted market prices in active markets for identical assets or liabilities.

Level 2: Observable market-based inputs or unobservable inputs that are corroborated by market data.

Level 3: Significant unobservable inputs that are not corroborated by market data.

The Company's current financial liabilities have fair values that approximate their carrying values. The Company's long-term financial liabilities consist of long-term debt, which is recorded on the balance sheet at issuance price and adjusted for any applicable unamortized discounts or premiums. There have been no material changes to the valuation techniques utilized in the fair value measurement of assets and liabilities as disclosed in the Company's Form 10-K for the fiscal year ended September 1, 2013.

Merchandise Inventories

Merchandise inventories are valued at the lower of cost or market, as determined primarily by the retail inventory method, and are stated using the last-in, first-out (LIFO) method for substantially all U.S. merchandise inventories. Merchandise inventories for all foreign operations are primarily valued by the retail inventory method and are stated using the first-in, first-out (FIFO) method. The Company believes the LIFO method more fairly presents the results of operations by more closely matching current costs with current revenues. The Company records an adjustment each quarter, if necessary, for the projected annual effect of inflation or deflation, and these estimates are adjusted to actual results determined at year-end, after actual inflation rates and inventory levels for the year have been determined.

Due to overall net inflationary trends in the third quarter and first thirty-six weeks of 2014, a charge of \$12 and \$18 was recorded to merchandise costs, respectively, to increase the cumulative LIFO valuation on merchandise inventories. A benefit of \$8 and \$19 was recorded to merchandise costs in the third quarter and first thirty-six weeks of 2013, respectively. At May 11, 2014, and September 1, 2013, the cumulative impact of the LIFO valuation on merchandise inventories was \$99 and \$81, respectively.

Derivatives

The Company is exposed to foreign-currency exchange-rate fluctuations in the normal course of business. It manages these fluctuations, in part, through the use of forward foreign-exchange contracts, seeking to economically hedge the impact of fluctuations of foreign exchange on known future expenditures denominated in a non-functional foreign-currency. The contracts relate primarily to U.S. dollar merchandise inventory expenditures made by the Company's international subsidiaries, whose functional currency is not the U.S. dollar. These contracts do not qualify for derivative hedge accounting. The Company seeks to mitigate risk with the use of these contracts and does not intend to engage in speculative transactions. These contracts do not contain any credit-risk-related contingent features. The aggregate notional amounts of open, unsettled forward foreign-exchange contracts were \$556 and \$458 at May 11, 2014, and September 1, 2013, respectively. While the Company seeks to manage counterparty risk associated with these contracts by limiting transactions to counterparties with which the Company has an established banking relationship, there can be no assurance that this practice is effective. The contracts are limited to less than one year in

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Note 1—Summary of Significant Accounting Policies (Continued)

duration. See Note 3 for information on the fair value of unsettled forward foreign-exchange contracts as of May 11, 2014, and September 1, 2013.

The unrealized gains or losses recognized in interest income and other, net in the accompanying condensed consolidated statements of income relating to the net changes in the fair value of unsettled forward foreign-exchange contracts were immaterial in the third quarter and the first thirty-six weeks of 2014 and 2013.

The Company is exposed to fluctuations in prices for the energy it consumes, particularly electricity and natural gas, which it seeks to partially mitigate through the use of fixed-price contracts for certain of its warehouses and other facilities, primarily in the U.S. and Canada. The Company also enters into variable-priced contracts for some purchases of electricity and natural gas, in addition to fuel for its gas stations, on an index basis. These contracts meet the characteristics of derivative instruments, but generally qualify for the “normal purchases or normal sales” exception under authoritative guidance and thus require no mark-to-market adjustment.

Foreign Currency

The Company recognizes foreign-currency transaction gains and losses related to revaluing or settling all monetary assets and liabilities denominated in currencies other than the functional currency in interest income and other, net in the accompanying condensed consolidated statements of income. Generally, this includes the U.S. dollar cash and cash equivalents and the U.S. dollar payables of consolidated subsidiaries to their functional currency. Also included are realized foreign-currency gains or losses from settlements of forward foreign-exchange contracts. These items resulted in an immaterial net gain in the third quarter and the first thirty-six weeks of 2014 and 2013.

Stock Repurchase Programs

Repurchased shares of common stock are retired, in accordance with the Washington Business Corporation Act. The par value of repurchased shares is deducted from common stock and the excess repurchase price over par value is deducted by allocation to both additional paid-in capital and retained earnings. The amount allocated to additional paid-in capital is calculated as the current value of additional paid-in capital per share outstanding and is applied to the number of shares repurchased. Any remaining amount is allocated to retained earnings. See Note 5 for additional information.

Recently Adopted Accounting Pronouncements

In February 2013, the Financial Accounting Standards Board (FASB) issued guidance related to reclassifications out of accumulated other comprehensive income. Disclosure is required of the net income line items impacted by significant reclassifications out of accumulated other comprehensive income if the item is reclassified in its entirety. For other amounts that are not required to be reclassified in their entirety to net income, cross-references to other disclosures required under U.S. GAAP are required. The new guidance was effective for fiscal years, and interim periods within those years, beginning after December 15, 2012. The Company adopted this guidance at the beginning of its first quarter of 2014. Adoption did not have a material impact on the Company’s condensed consolidated financial statements or disclosures.

Recent Accounting Pronouncements Not Yet Adopted

In April 2014, the FASB issued guidance that changed the criteria for reporting discontinued operations, as well as requiring new disclosures about discontinued operations and disposals of components of an entity that do not qualify for discontinued operations reporting. This guidance is effective for fiscal years beginning after December 15, 2014, with early adoption permitted for disposals that have not been reported in financial statements previously issued. The Company will adopt this guidance at the beginning of its first quarter of fiscal year 2016. Adoption of this guidance is not expected to have a material impact on the Company’s consolidated financial statements or disclosures.

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Note 1—Summary of Significant Accounting Policies (Continued)

In May 2014, the International Accounting Standards Board (IASB) and FASB issued a jointly converged standard on the recognition of revenue from contracts with customers. The issued guidance converges the criteria for reporting revenue, as well as requiring disclosures sufficient to describe the nature, amount, timing, and uncertainty of revenue and cash flows arising from these contracts. Companies can transition to the standard either retrospectively or as a cumulative effective adjustment as of the date of adoption. The new standard is effective for fiscal years, and interim periods within those years, beginning after December 15, 2016. The Company plans to adopt this guidance at the beginning of its first quarter of fiscal year 2018. The Company is evaluating the impact of this standard on its consolidated financial statements and disclosures.

Note 2—Investments

The Company's major categories of investments have not materially changed from the annual reporting period ended September 1, 2013. The Company's investments were as follows:

| May 11, 2014: | Cost Basis | Unrealized Gains, Net | Recorded Basis |
|--------------------------------------|---------------|--------------------------|-------------------|
| Available-for-sale: | | | |
| Government and agency securities | \$1,364 | \$2 | \$1,366 |
| Asset and mortgage-backed securities | 5 | 0 | 5 |
| Total available-for-sale | 1,369 | 2 | 1,371 |
| Held-to-maturity: | | | |
| Certificates of deposit | 145 | | 145 |
| Bankers' acceptances | 23 | | 23 |
| Total held-to-maturity | 168 | | 168 |
| Total short-term investments | \$1,537 | \$2 | \$1,539 |
| September 1, 2013: | Cost Basis | Unrealized Gains, Net | Recorded Basis |
| Available-for-sale: | | | |
| Government and agency securities | \$1,263 | \$0 | \$1,263 |
| Corporate notes and bonds | 9 | 0 | 9 |
| Asset and mortgage-backed securities | 5 | 0 | 5 |
| Total available-for-sale | 1,277 | 0 | 1,277 |
| Held-to-maturity: | | | |
| Certificates of deposit | 124 | | 124 |
| Bankers' acceptances | 79 | | 79 |
| Total held-to-maturity | 203 | | 203 |
| Total short-term investments | \$1,480 | \$0 | \$1,480 |

At May 11, 2014, the Company's available-for-sale securities that were in continuous unrealized-loss positions were not material. At September 1, 2013, the Company had no available-for-sale securities that were in continuous unrealized-loss positions. At May 11, 2014, and September 1, 2013, the Company had no gross unrealized gains and losses on cash equivalents.

The proceeds from sales of available-for-sale securities were \$11 and \$81 during the third quarter of 2014 and 2013, respectively. In the first thirty-six weeks of 2014 and 2013, the proceeds from sales of available-

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Note 2—Investments (Continued)

for-sale securities were \$43 and \$201, respectively. Gross realized gains or losses from sales of available-for-sale securities during the third quarter and first thirty-six weeks of 2014 and 2013 were not material.

The maturities of available-for-sale and held-to-maturity securities at May 11, 2014, were as follows:

| | Available-For-Sale | | Held-To-Maturity |
|---------------------------------------|--------------------|------------|------------------|
| | Cost Basis | Fair Value | |
| Due in one year or less | \$294 | \$295 | \$ 168 |
| Due after one year through five years | 1,061 | 1,062 | 0 |
| Due after five years | 14 | 14 | 0 |
| | \$1,369 | \$1,371 | \$ 168 |

Note 3—Fair Value Measurement

Assets and Liabilities Measured at Fair Value on a Recurring Basis

The tables below present information regarding the Company's financial assets and financial liabilities that are measured at fair value on a recurring basis and indicate the level within the fair value hierarchy reflecting the valuation techniques utilized to determine fair value.

| | | |
|--|---------|---------|
| May 11, 2014: | Level 1 | Level 2 |
| Money market mutual funds ⁽¹⁾ | \$124 | \$0 |
| Investment in government and agency securities ⁽²⁾ | 0 | 1,399 |
| Investment in asset and mortgage-backed securities | 0 | 5 |
| Forward foreign-exchange contracts, in asset position ⁽³⁾ | 0 | 0 |
| Forward foreign-exchange contracts, in (liability) position ⁽³⁾ | 0 | (12) |
| Total | \$124 | \$1,392 |
| September 1, 2013: | Level 1 | Level 2 |
| Money market mutual funds ⁽¹⁾ | \$87 | \$0 |
| Investment in government and agency securities ⁽²⁾ | 0 | 1,263 |
| Investment in corporate notes and bonds | 0 | 9 |
| Investment in asset and mortgage-backed securities | 0 | 5 |
| Forward foreign-exchange contracts, in asset position ⁽³⁾ | 0 | 3 |
| Forward foreign-exchange contracts, in (liability) position ⁽³⁾ | 0 | (3) |
| Total | \$87 | \$1,277 |

(1) Included in cash and cash equivalents in the accompanying condensed consolidated balance sheets.

On May 11, 2014, \$33 and \$1,366 included in cash and cash equivalents and short-term investments, respectively, in the accompanying condensed consolidated balance sheets. On September 1, 2013, there were no securities

(2) included in cash and cash equivalents and \$1,263 included in short-term investments in the accompanying consolidated balance sheets.

The asset and the liability values are included in deferred income taxes and other current assets and other current (3) liabilities, respectively, in the accompanying condensed consolidated balance sheets. See Note 1 for additional information on derivative instruments.

The Company did not hold any Level 3 financial assets and liabilities that were measured at fair value on a recurring basis at May 11, 2014, or September 1, 2013. There were no financial assets and liabilities measured on a recurring basis using significant unobservable inputs (Level 3) and there were no transfers in or out of Level 1, 2, or 3 during the third quarter or first thirty-six weeks of 2014 or 2013.

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Note 3—Fair Value Measurement (Continued)

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

Financial assets measured at fair value on a nonrecurring basis include held-to-maturity investments that are carried at amortized cost and are not remeasured to fair value on a recurring basis. There were no fair value adjustments to these financial assets during the third quarter and first thirty-six weeks of 2014 or 2013.

Nonfinancial assets measured at fair value on a nonrecurring basis include items such as long-lived assets that are measured at fair value resulting from an impairment, if deemed necessary. There were no fair value adjustments to these nonfinancial assets and liabilities during the third quarter and were immaterial for the first thirty-six weeks 2014. Fair value adjustments were immaterial for the third quarter and first thirty-six weeks of 2013.

Note 4—Debt

The carrying value and estimated fair value of the Company's long-term debt consisted of the following:

| | May 11, 2014 | | September 1, 2013 | |
|---|----------------|------------|-------------------|------------|
| | Carrying Value | Fair Value | Carrying Value | Fair Value |
| 5.5% Senior Notes due March 2017 | \$1,098 | \$1,236 | \$1,098 | \$1,248 |
| 0.65% Senior Notes due December 2015 | 1,199 | 1,206 | 1,199 | 1,200 |
| 1.125% Senior Notes due December 2017 | 1,100 | 1,095 | 1,100 | 1,065 |
| 1.7% Senior Notes due December 2019 | 1,198 | 1,179 | 1,198 | 1,157 |
| Other long-term debt | 390 | 399 | 403 | 412 |
| Long-term debt, excluding current portion | \$4,985 | \$5,115 | \$4,998 | \$5,082 |

The estimated fair value of the Company's debt was based primarily on reported market values, recently completed market transactions, and estimates based upon interest rates, maturities, and credit risk. Substantially all of the Company's long-term debt is classified as Level 2.

Note 5—Equity and Comprehensive Income

Dividends

The Company's current quarterly dividend rate is \$0.355 per share, compared to \$0.31 per share in the third quarter of 2013. On April 29, 2014, the Board of Directors declared a quarterly cash dividend in the amount of \$0.355 per share, which was paid on May 30, 2014.

Stock Repurchase Programs

The Company's stock repurchase activity during the third quarter and first thirty-six weeks of 2014 and 2013 is summarized below:

| | Shares Repurchased (000's) | Average Price per Share | Total Cost |
|--------------------------------|----------------------------|-------------------------|------------|
| Third quarter of 2014 | 1,623 | \$113.14 | \$184 |
| First thirty-six weeks of 2014 | 1,623 | 113.14 | 184 |
| Third quarter of 2013 | 0 | \$0 | \$0 |
| First thirty-six weeks of 2013 | 357 | 96.41 | 34 |

The remaining amount available for stock repurchases under our approved plan was \$2,871 at May 11, 2014. These amounts differ from the stock repurchase balances in the condensed consolidated statements of cash flows due to changes in unsettled stock repurchases at the end of a quarter. Purchases are made

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Note 5—Equity and Comprehensive Income (Continued)

from time-to-time, as conditions warrant, in the open market or in block purchases, and pursuant to plans under SEC Rule 10b5-1.

Components of Equity and Comprehensive Income

The following tables show the changes in equity attributable to Costco and the noncontrolling interests of consolidated subsidiaries and other entities in which the Company has a controlling interest, but less than total ownership:

| | Attributable to Costco | Noncontrolling Interests | Total Equity |
|--|---------------------------|-----------------------------|-----------------|
| Equity at September 1, 2013 | \$10,833 | \$179 | \$11,012 |
| Comprehensive income: | | | |
| Net income | 1,361 | 22 | 1,383 |
| Foreign-currency translation adjustment and other, net | 53 | 1 | 54 |
| Comprehensive income | 1,414 | 23 | 1,437 |
| Stock-based compensation | 251 | 0 | 251 |
| Stock options exercised, including tax effects | 35 | 0 | 35 |
| Release of vested restricted stock units (RSUs), including tax effects | (101 |) 0 | (101) |
| Repurchases of common stock | (184 |) 0 | (184) |
| Cash dividends declared | (429 |) 0 | (429) |
| Equity at May 11, 2014 | \$11,819 | \$202 | \$12,021 |
| | Attributable to Costco | Noncontrolling Interests | Total Equity |
| Equity at September 2, 2012 | \$12,361 | \$157 | \$12,518 |
| Comprehensive income: | | | |
| Net income | 1,422 | 17 | 1,439 |
| Foreign-currency translation adjustment and other, net | (75 |) 1 | (74) |
| Comprehensive income | 1,347 | 18 | 1,365 |
| Stock-based compensation | 210 | 0 | 210 |
| Stock options exercised, including tax effects | 67 | 0 | 67 |
| Release of vested RSUs, including tax effects | (85 |) 0 | (85) |
| Conversion of convertible notes | 30 | 0 | 30 |
| Repurchases of common stock | (34 |) 0 | (34) |
| Cash dividends declared | (3,424 |) 0 | (3,424) |
| Equity at May 12, 2013 | \$10,472 | \$175 | \$10,647 |

Note 6—Stock-Based Compensation

In the second quarter of fiscal 2012, the Fifth Restated 2002 Stock Incentive Plan was amended following shareholder approval and is now referred to as the Sixth Restated 2002 Stock Incentive Plan (Sixth Plan). The Sixth Plan initially authorized the issuance of 16,000,000 shares (9,143,000 RSUs) of common stock for future grants in addition to shares authorized under the previous plan. The Company issues new shares of common stock upon exercise of stock options and upon vesting of RSUs. Shares for vested RSUs are generally delivered to participants annually, net of shares equal to the minimum statutory withholding taxes.

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Note 6—Stock-Based Compensation (Continued)

Summary of Restricted Stock Unit Activity

At May 11, 2014, 7,918,000 shares were available to be granted as RSUs and the following awards were outstanding: 8,577,000 time-based RSUs that vest upon continued employment over specified periods of time; 343,000 performance-based RSUs granted to certain executive officers of the Company for which the performance targets have been met. Further restrictions lapse upon achievement of continued employment over specified periods of time; and 269,000 performance-based RSUs to be granted to executive officers of the Company upon achievement of performance targets for fiscal 2014, as determined by the Compensation Committee of the Board of Directors after the end of the fiscal year. These awards are included in the table below and the Company recognized compensation expense for these awards as it is currently deemed probable that the targets will be achieved.

The following table summarizes RSU transactions during the first thirty-six weeks of 2014:

| | Number of Units (in 000's) | Weighted-Average Grant Date Fair Value |
|----------------------------------|----------------------------------|--|
| Outstanding at September 1, 2013 | 10,081 | \$72.52 |
| Granted | 3,456 | 113.64 |
| Vested and delivered | (4,148 |) 72.46 |
| Forfeited | (200 |) 81.01 |
| Outstanding at May 11, 2014 | 9,189 | \$86.84 |

The remaining unrecognized compensation cost related to non-vested RSUs at May 11, 2014 was \$631, and the weighted-average period of time over which this cost will be recognized is 1.8 years.

Summary of Stock Option Activity

All outstanding stock options were fully vested and exercisable at May 11, 2014, and September 1, 2013. The following table summarizes stock option transactions:

| | Number Of Options (in 000's) | Weighted- Average Exercise Price | Weighted- Average Remaining Contractual Term (in years) | Aggregate Intrinsic Value ⁽¹⁾ |
|----------------------------------|------------------------------------|---|--|--|
| Outstanding at September 1, 2013 | 1,947 | \$39.70 | | |
| Exercised | (591 |) 36.89 | | |
| Outstanding at May 11, 2014 | 1,356 | \$40.92 | 0.90 | \$101 |

(1) The difference between the exercise price and the market value of common stock at May 11, 2014.

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Note 6—Stock-Based Compensation (Continued)

The tax benefits realized, derived from the compensation deductions resulting from the option exercises, and intrinsic value related to total stock options exercised are provided in the following table:

| | 36 Weeks Ended | |
|---|-----------------|-----------------|
| | May 11, 2014 | May 12, 2013 |
| Actual tax benefit realized for stock options exercised | \$16 | \$30 |
| Intrinsic value of stock options exercised ⁽¹⁾ | \$47 | \$84 |

(1) The difference between the exercise price and the market value of common stock measured at each exercise date.

Summary of Stock-Based Compensation

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

| | 12 Weeks Ended | | 36 Weeks Ended | |
|---|-----------------|-----------------|-----------------|-----------------|
| | May 11, 2014 | May 12, 2013 | May 11, 2014 | May 12, 2013 |
| Stock-based compensation expense before income taxes | \$66 | \$51 | \$251 | \$210 |
| Less recognized income tax benefit | (22 |) (16 |) (84 |) (69 |
| Stock-based compensation expense, net of income taxes | \$44 | \$35 | \$167 | \$141 |

Note 7—Income Taxes

The Company's actual effective tax rates for the twelve and thirty-six weeks ended May 11, 2014, were 33.9% and 34.5%, respectively, compared to 34.8% and 31.4% for the twelve and thirty-six weeks ended May 12, 2013, respectively, which includes the net impact of discrete tax items. The actual effective tax rate for the third quarter of 2014 was favorably impacted by a change in the estimated annual effective tax rate which decreased from 35.2% in the second quarter of 2014 to 34.8%. This change in estimate was predominately due to a change in expected annual pre-tax income between the Company's domestic and international operations. For the third quarter and first thirty-six weeks of 2013 the estimated annual effective tax rate was 34.8%. Estimated annual effective tax rates exclude the impact of discrete tax items.

The Company's effective tax rate for for the first thirty-six weeks of 2013 was favorably impacted by discrete net tax benefits of \$72, primarily due to a \$62 tax benefit recorded in the second quarter of 2013 in connection with the special cash dividend paid to employees through our 401(k) Retirement Plan. Dividends paid on these shares were deductible for U.S. income tax purposes.

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Note 8—Net Income per Common and Common Equivalent Share

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

| | 12 Weeks Ended | | 36 Weeks Ended | |
|--|-----------------|-----------------|-----------------|-----------------|
| | May 11, 2014 | May 12, 2013 | May 11, 2014 | May 12, 2013 |
| Net income available to common stockholders after assumed conversions of dilutive securities | \$473 | \$459 | \$1,361 | \$1,422 |
| Weighted average number of common shares used in basic net income per common share | 439,446 | 436,488 | 439,058 | 435,293 |
| RSUs and stock options | 3,259 | 4,260 | 3,569 | 4,142 |
| Conversion of convertible notes | 15 | 32 | 24 | 303 |
| Weighted average number of common shares and dilutive potential of common stock used in diluted net income per share | 442,720 | 440,780 | 442,651 | 439,738 |

Note 9—Commitments and Contingencies

Legal Proceedings

The Company is involved in a number of claims, proceedings and litigation arising from its business and property ownership. In accordance with applicable accounting guidance, the Company establishes an accrual for legal proceedings if and when those matters reach a stage where they present loss contingencies that are both probable and reasonably estimable. In such cases, there may be a possible exposure to loss in excess of any amounts accrued. The Company monitors those matters for developments that would affect the likelihood of a loss and the accrued amount, if any, thereof, and adjusts the amount as appropriate. If the loss contingency at issue is not both probable and reasonably estimable, the Company does not establish an accrual, but will continue to monitor the matter for developments that will make the loss contingency both probable and reasonably estimable. As of the date of this report, the Company has recorded an immaterial accrual with respect to one matter described below. In each case, there is a reasonable possibility that a loss may be incurred. For matters where no accrual has been recorded, the possible loss or range of loss cannot in our view be reasonably estimated because, among other things, (i) the remedies or penalties sought are indeterminate or unspecified, (ii) the legal and/or factual theories are not well developed, and/or (iii) the matters involve complex or novel legal theories or a large number of parties.

The Company is a defendant in the following matters, among others:

A case brought as a class action on behalf of certain present and former female managers, in which plaintiffs allege denial of promotion based on gender in violation of Title VII of the Civil Rights Act of 1964 and California state law. Shirley “Rae” Ellis v. Costco Wholesale Corp., United States District Court (San Francisco), Case No. C-04-3341-EMC. Plaintiffs seek compensatory damages, punitive damages, injunctive relief, interest and attorneys’ fees. Class certification was granted by the district court on January 11, 2007. On September 16, 2011, the United States Court of Appeals for the Ninth Circuit reversed the order of class certification and remanded to the district court for further proceedings. On September 25, 2012, the district court certified a class of women in the United States denied promotion to warehouse general manager or assistant general manager since January 3, 2002. The class is less than 1,300 people. In February 2014 the court granted preliminary approval of a proposed settlement. Any payments to class members under the proposed settlement would be contingent upon proof of liability in individual adjudications. The court granted final approval on May 27, 2014. Payments under the settlement will be immaterial to the Company’s operations and financial position.

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Note 9—Commitments and Contingencies (Continued)

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. 07-1754 (S.D. Cal.). On June 18, 2007, the Judicial Panel on Multidistrict Litigation assigned the action, entitled In re Motor Fuel Temperature Sales Practices Litigation, MDL Docket No 1840, to Judge Kathryn Vratil in the United States District Court for the District of Kansas. On April 12, 2009, the Company agreed to settle the actions in which it is named as a defendant. Under the settlement, which was subject to final approval by the court, the Company agreed, to the extent allowed by law and subject to other terms and conditions in the agreement, to install over five years from the effective date of the settlement temperature-correcting dispensers in the States of Alabama, Arizona, California, Florida, Georgia, Kentucky, Nevada, New Mexico, North Carolina, South Carolina, Tennessee, Texas, Utah, and Virginia. Other than payments to class representatives, the settlement does not provide for cash payments to class members. On September 22, 2011, the court preliminarily approved a revised settlement, which did not materially alter the terms. On April 24, 2012, the court granted final approval of the revised settlement. A class member who objected has filed a notice of appeal from the order approving the settlement. Plaintiffs have moved for an award of \$10 million in attorneys' fees, as well as an award of costs and payments to class representatives. The Company has opposed the motion. On March 20, 2014, the Company filed a notice invoking a "most favored nation" provision under the settlement, under which it seeks to adopt provisions in later settlements with certain other defendants, an invocation that class counsel has opposed.

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 has entered into a tolling agreement with the United States Attorney's Office.

The Environmental Protection Agency issued an Information Request to the Company, dated November 1, 2007, regarding warehouses in the states of Arizona, California, Hawaii, and Nevada and relating to compliance with regulations concerning air-conditioning and refrigeration equipment. On March 4, 2009, the Company was advised by the Department of Justice that the Department was prepared to allege that the Company has committed at least nineteen violations of the leak-repair requirements of 40 C.F.R. § 82.156(i) and at least seventy-four violations of the recordkeeping requirements of 40 C.F.R. § 82.166(k), (m) at warehouses in these states. The Company has responded to these allegations, is engaged in communications with the Department about these and additional allegations, and

has entered into tolling agreements. Substantial penalties may be levied for violations of the Clean Air Act. The Company is cooperating with this inquiry.

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Note 9—Commitments and Contingencies (Continued)

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

The Company has received from the Drug Enforcement Administration subpoenas and administrative inspection warrants concerning the Company's fulfillment of prescriptions related to controlled substances and related practices. The Company is seeking to cooperate with these processes.

The Company does not believe that any pending claim, proceeding or litigation, either alone or in the aggregate, will have a material adverse effect on the Company's financial position; however, it is possible that an unfavorable outcome of some or all of the matters, however unlikely, could result in a charge that might be material to the results of an individual fiscal quarter.

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Note 10—Segment Reporting

The Company and its subsidiaries are principally engaged in the operation of membership warehouses in the U.S., Canada, Mexico, United Kingdom, Japan, and Australia and through majority-owned subsidiaries in Taiwan and Korea. Reportable segments are largely based on management's organization of the operating segments for operational decisions and assessments of financial performance, which considers geographic locations. The material accounting policies of the segments are the same as 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 1, 2013, and Note 1 above. All material inter-segment net sales and expenses have been eliminated in computing total revenue and operating income. Certain operating expenses, predominantly stock-based compensation, are incurred on behalf of the Company's Canadian and Other International Operations, but are included in the U.S. Operations because those costs are not allocated internally and generally come under the responsibility of the Company's U.S. management team.

| | United States Operations | Canadian Operations | Other International Operations | Total |
|-------------------------------------|-----------------------------|------------------------|--------------------------------------|------------|
| Twelve Weeks Ended May 11, 2014 | | | | |
| Total revenue | \$ 18,655 | \$ 3,940 | \$ 3,199 | \$ 25,794 |
| Operating income | 445 | 172 | 120 | 737 |
| Depreciation and amortization | 173 | 28 | 36 | 237 |
| Additions to property and equipment | 243 | 40 | 122 | 405 |
| Twelve Weeks Ended May 12, 2013 | | | | |
| Total revenue | \$ 17,444 | \$ 3,857 | \$ 2,782 | \$ 24,083 |
| Operating income | 452 | 172 | 98 | 722 |
| Depreciation and amortization | 163 | 29 | 29 | 221 |
| Additions to property and equipment | 194 | 30 | 212 | 436 |
| Thirty-Six Weeks Ended May 11, 2014 | | | | |
| Total revenue | \$ 55,238 | \$ 12,120 | \$ 9,759 | \$ 77,117 |
| Operating income | 1,233 | 522 | 374 | 2,129 |
| Depreciation and amortization | 517 | 87 | 104 | 708 |
| Additions to property and equipment | 856 | 158 | 412 | 1,426 |
| Net property and equipment | 9,960 | 1,640 | 2,983 | 14,583 |
| Total assets | 21,933 | 4,732 | 6,036 | 32,701 |
| Thirty-Six Weeks Ended May 12, 2013 | | | | |
| Total revenue | \$ 52,156 | \$ 11,748 | \$ 8,765 | \$ 72,669 |
| Operating income | 1,248 | 504 | 347 | 2,099 |
| Depreciation and amortization | 478 | 85 | 88 | 651 |
| Additions to property and equipment | 704 | 122 | 553 | 1,379 |
| Net property and equipment | 9,456 | 1,655 | 2,435 | 13,546 |
| Total assets | 20,518 | 4,578 | 4,910 | 30,006 |
| Year Ended September 1, 2013 | | | | |
| Total revenue | \$ 75,493 | \$ 17,179 | \$ 12,484 | \$ 105,156 |
| Operating income | 1,810 | 756 | 487 | 3,053 |
| Depreciation and amortization | 696 | 123 | 127 | 946 |
| Additions to property and equipment | 1,090 | 186 | 807 | 2,083 |
| Net property and equipment | 9,652 | 1,621 | 2,608 | 13,881 |
| Total assets | 20,608 | 4,529 | 5,146 | 30,283 |

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Item 2—Management’s Discussion and Analysis of Financial Condition and Results of Operations (amounts in millions, except per share and share data, and warehouse count data)

FORWARD-LOOKING STATEMENTS

Certain statements contained in this Report constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, and Section 21E of the Securities Exchange Act of 1934. They include statements that address activities, events, conditions or developments that we expect or anticipate may occur in the future and may relate to such matters as sales growth, increases in comparable store sales, cannibalization of existing locations by new openings, price or fee changes, earnings performance, earnings per share, stock-based compensation expense, warehouse openings and closures, the amount we expect to spend on our expansion plans, the effect of adopting certain accounting standards, future financial reporting, financing, margins, return on invested capital, strategic direction, expense controls, membership renewal rates, shopping frequency, litigation impact and the demand for our products and services. Forward-looking statements may also be identified by the words “believe,” “project,” “expect,” “anticipate,” “estimate,” “intend,” “strategy,” “future,” “opportunity,” “may,” “should,” “will,” “would,” “will be,” “will continue,” “will likely result,” and similar expressions. 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, uncertainties in the financial markets, consumer and small business spending patterns and debt levels, breaches of security or privacy of member or business information, conditions affecting the acquisition, development, ownership or use of real estate, actions of vendors, rising costs associated with employees (including health care costs), energy and certain commodities, geopolitical conditions, and other risks identified from time to time in the Company's public statements and reports filed with the SEC. Forward-looking statements speak only as of the date they are made, and we do not undertake to update these forward-looking statements, except as required by law.

This management discussion should be read in conjunction with the management discussion included in our fiscal 2013 annual report on Form 10-K, previously filed with the SEC.

OVERVIEW

We operate membership warehouses based on the concept that offering our members low prices on a limited selection of nationally branded and select private-label products in a wide range of merchandise categories will produce high sales volumes and rapid turnover. This turnover, when combined with the operating efficiencies achieved by volume purchasing, efficient distribution and reduced handling of merchandise in no-frills, self-service warehouse facilities, enables us to operate profitably at significantly lower gross margins than traditional wholesalers, mass merchandisers, supermarkets, and supercenters.

We believe that the most important driver of increasing our profitability is sales growth, particularly comparable sales growth. We define comparable warehouse sales as sales from warehouses open for more than one year, including remodels, relocations and expansions, as well as online sales related to websites launched for more than one year. Comparable sales growth is achieved through increasing the frequency with which our members shop and the amounts that they spend on each visit. Sales comparisons can also be particularly influenced by two factors that are beyond our control, including fluctuations in currency exchange rates (with respect to the consolidation of the results of our international operations) and changes in the cost of gasoline and associated competitive conditions (primarily impacting domestic operations). The higher our comparable sales exclusive of these items, the more we can leverage certain of our selling, general and administrative expenses, reducing them as a percentage of sales and enhancing profitability. Generating comparable sales growth is foremost a question of making available to our members the right merchandise at the right prices, a skill that we believe we have repeatedly demonstrated over the long term. Another substantial factor in sales growth is the health of the economies in which we do business, especially the United States. Sales growth and gross margins are also impacted by our competition, which is vigorous and widespread, including a wide range of global, national and regional wholesalers and retailers, including supermarkets, supercenter

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Item 2—Management’s Discussion and Analysis of Financial Condition and Results of Operations (Continued) (amounts in millions, except per share and share data, and warehouse count data)

stores, department and specialty stores, gasoline stations, and internet-based retailers. While we cannot control or reliably predict general economic health or changes in competition, we believe that we have been successful historically in adapting our business to these changes, such as through adjustments to our pricing and to our merchandise mix, including increasing the penetration of our private label items. Our philosophy is not to focus in the short term on maximizing prices that our members can be charged, but to maintain what we believe is a perception among our members of our “pricing authority” – consistently providing the most competitive values. Our investments in merchandise pricing can, from time to time, include reducing prices on merchandise to drive sales or meet competition and holding prices steady despite cost increases instead of passing the increases on to our members, all negatively impacting near-term gross margin as a percentage of sales.

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

Our membership format is an integral part of our business model and has a significant effect on our profitability. This format is designed to reinforce member loyalty and provide continuing fee revenue. The extent to which we maintain growth in our membership base, upgrade members, and sustain high renewal rates materially influences our profitability.

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

Our operating model is generally the same across our U.S., Canada, and Other International operating segments (see Part I, Item 1, Note 10 of this Report). Certain countries in the Other International segment have relatively higher rates of square footage growth, lower wages and benefit costs as a percentage of country sales, and/or less direct membership warehouse competition. Additionally, we operate our lower-margin gasoline business predominately in the United States and Canada.

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

Our fiscal year ends on the Sunday closest to August 31. References to the third quarters of 2014 and 2013 relate to the twelve-week fiscal quarters ended May 11, 2014, and May 12, 2013, respectively. References to the first thirty-six weeks of 2014 and 2013 relate to the thirty-six weeks ended May 11, 2014, and May 12, 2013, respectively. Certain percentages presented are calculated using actual results prior to rounding. Unless otherwise noted, references to net income relate to net income attributable to Costco.

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Item 2—Management’s Discussion and Analysis of Financial Condition and Results of Operations (Continued) (amounts in millions, except per share and share data, and warehouse count data)

Key items for the third quarter of 2014 as compared to the third quarter of 2013 include:

- We opened four new warehouses in the third quarter of 2014, two in the U.S. and two in our Other International segment, compared to five new warehouses in the third quarter of 2013;
- Net sales increased 7% to \$25,233, driven by a 4% increase in comparable sales and sales at warehouses opened since the end of the third quarter of fiscal 2013. Net and comparable sales were negatively impacted by changes in certain foreign currencies relative to the U.S. dollar and by decreases in the price of gasoline;
- Membership fees increased 6% to \$561, primarily due to membership sign-ups at existing and new warehouses and increased penetration of our higher-fee Executive Membership program;
- Gross margin (net sales less merchandise costs) as a percentage of net sales decreased five basis points;
 - Selling, general and administrative (SG&A) expenses as a percentage of net sales increased four basis points;
- Net income increased 3% to \$473, or \$1.07 per diluted share compared to \$459, or \$1.04 per diluted share in 2013;
- Changes in foreign currencies relative to the U.S. dollar adversely impacted diluted earnings per share by \$0.03, primarily due to changes in the Canadian dollar; and
- On April 29, 2014, our Board of Directors declared a quarterly cash dividend in the amount of \$0.355 per share (reflecting an increase of 14.5%), which was paid subsequent to the end of the third quarter.

RESULTS OF OPERATIONS

Net Sales

| | 12 Weeks Ended | | 36 Weeks Ended | | |
|--|-----------------|-----------------|-----------------|-----------------|---|
| | May 11, 2014 | May 12, 2013 | May 11, 2014 | May 12, 2013 | |
| Net Sales | \$25,233 | \$23,552 | \$75,457 | \$71,099 | |
| Increases in net sales: | | | | | |
| U.S. | 7 | % 8 | % 6 | % 8 | % |
| International | 8 | % 8 | % 7 | % 11 | % |
| Total Company | 7 | % 8 | % 6 | % 8 | % |
| Increases in comparable warehouse sales: | | | | | |
| U.S. | 5 | % 6 | % 4 | % 6 | % |
| International | 3 | % 4 | % 1 | % 6 | % |
| Total Company | 4 | % 5 | % 3 | % 6 | % |
| Increases in comparable warehouse sales excluding the impact of gasoline price and foreign currency changes: | | | | | |
| U.S. | 6 | % 7 | % 5 | % 6 | % |
| International | 8 | % 7 | % 7 | % 6 | % |
| Total Company | 6 | % 7 | % 5 | % 6 | % |

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Item 2—Management’s Discussion and Analysis of Financial Condition and Results of Operations (Continued) (amounts in millions, except per share and share data, and warehouse count data)

Net Sales

Net Sales increased \$1,681 or 7%, and \$4,358 or 6% during the third quarter and first thirty-six weeks of 2014 compared to the third quarter and first thirty-six weeks of 2013. These increases were attributable to a 4% and 3% increase in comparable warehouse sales in the third quarter and first thirty-six weeks, respectively, and from sales at the 26 net new warehouses (includes the closure of our Acapulco, Mexico location due to storm damage) opened since the end of the third quarter of fiscal 2013.

During the third quarter, changes in foreign currencies relative to the U.S. dollar negatively impacted net sales by approximately \$343, or 146 basis points, compared to the third quarter of 2013. The negative impact was primarily due to the Canadian dollar of approximately \$320. Changes in gasoline prices negatively impacted net sales by approximately \$55, or 23 basis points, due to a 2% decrease in the average sales price per gallon.

During the first thirty-six weeks of 2014, changes in foreign currencies negatively impacted net sales by approximately \$1,200, or 169 basis points, compared to the first thirty-six weeks of 2013. The negative impact was primarily due to the Canadian dollar of approximately \$875 and the Japanese yen of approximately \$293. Changes in gasoline prices negatively impacted net sales by approximately \$363, or 51 basis points due to a 4.5% decrease in the average sales price per gallon.

Comparable Sales

Comparable sales increased 4% in the third quarter and were positively impacted primarily by an increase in shopping frequency. In the first thirty-six weeks of 2014, comparable sales increased 3% and were positively impacted by an increase in shopping frequency, partially offset by lower average amounts spent per visit by our members. Changes in foreign currencies relative to the U.S. dollar and gasoline prices negatively impacted comparable sales results, including the average amount spent by our members during the first thirty-six weeks of 2014. The increase in comparable sales also includes the negative impact of cannibalization (established warehouses losing sales to our newly opened locations), primarily in our Other International segment.

Membership Fees

| | 12 Weeks Ended | | 36 Weeks Ended | |
|--|-----------------|-----------------|-----------------|-----------------|
| | May 11, 2014 | May 12, 2013 | May 11, 2014 | May 12, 2013 |
| Membership fees | \$561 | \$531 | \$1,660 | \$1,570 |
| Membership fees as a percentage of net sales | 2.22 | % 2.25 | % 2.20 | % 2.21 |
| Total paid cardholders (000's) | 40,900 | 38,300 | 40,900 | 38,300 |
| Total cardholders (000's) | 74,600 | 69,900 | 74,600 | 69,900 |

Membership fees increased 6% in both the third quarter and first thirty-six weeks of 2014, respectively. These increases were primarily due to membership sign-ups at existing and new warehouses and increased penetration of our higher-fee Executive Membership program. The raising of our membership fees in fiscal 2012 had no impact on the third quarter of 2014 and positively impacted the first thirty-six weeks of 2014 by \$9. These increases were partially offset by changes in foreign currencies relative to the U.S. dollar, which negatively impacted membership fees by approximately \$8 and \$31 for the third quarter and first thirty-six weeks of 2014, respectively. Our member renewal rates are currently 91% in the U.S. and Canada and 87% worldwide.

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Item 2—Management’s Discussion and Analysis of Financial Condition and Results of Operations (Continued) (amounts in millions, except per share and share data, and warehouse count data)

Gross Margin

| | 12 Weeks Ended | | 36 Weeks Ended | |
|---|-----------------|-----------------|-----------------|-----------------|
| | May 11, 2014 | May 12, 2013 | May 11, 2014 | May 12, 2013 |
| Net sales | \$25,233 | \$23,552 | \$75,457 | \$71,099 |
| Less merchandise costs | 22,554 | 21,038 | 67,421 | 63,530 |
| Gross margin | \$2,679 | \$2,514 | \$8,036 | \$7,569 |
| Gross margin as a percentage of net sales | 10.62 | % 10.67 | % 10.65 | % 10.65 |

Quarterly results

Gross margin as a percentage of net sales decreased five basis points compared to the third quarter of 2013. Excluding the negative effect of gasoline price deflation on net sales, gross margin as a percentage of net sales decreased eight basis points. Gross margin in our core merchandise categories (food and sundries, hardlines, softlines and fresh foods) when expressed as a percentage of net sales, excluding gasoline price deflation, increased seven basis points.

Warehouse ancillary and other businesses gross margin when expressed as a percentage of net sales was unchanged. Additionally, gross margin was negatively impacted by eight basis points due to a LIFO charge of \$12 in the third quarter of 2014, compared to a benefit of \$8 in 2013, and seven basis points due to a non-recurring legal settlement received in the third quarter of 2013. The LIFO charge resulted from higher merchandise inventory costs, primarily food and sundries. Executive Membership 2% reward program, when expressed as a percentage of net sales, was consistent quarter over quarter. Excluding the effect of changes in foreign currencies, the Executive Membership 2% reward program negatively impacted gross margin by one basis point due to the continued growth of this program. Changes in foreign currencies relative to the U.S. dollar negatively impacted gross margin by \$39 in the third quarter of 2014.

Gross margin in our core merchandise categories when expressed as a percentage of their own sales, excluding gasoline price deflation, increased in our food and sundries, softlines, and hardlines categories, partially offset by a decrease in our fresh foods category.

Gross margin on a segment basis, when expressed as a percentage of the segment’s own sales (gross margin percentage), decreased in our U.S. operations, primarily due to the LIFO charge and non-recurring legal settlement discussed above. Excluding these items, the gross margin in our U.S. operations increased compared to the prior year, primarily due to increases in food and sundries and softlines. The gross margin percentage in our Canadian operations decreased primarily due to decreases in hardlines as a result of its lower sales penetration as discussed above, as well as, decreases in food and sundries and softlines. The gross margin percentage in our Other International segment increased, primarily due to fresh foods.

Year-to-date results

Gross margin as a percentage of net sales was consistent compared to the first thirty-six weeks of 2013. Excluding the effect of gasoline price deflation on net sales, gross margin as a percentage of net sales decreased five basis points. Gross margin in our core merchandise categories when expressed as a percentage of net sales, excluding gasoline price deflation, increased two basis points, primarily due to increases in food and sundries and softlines, partially offset by a decrease in hardlines as a result of its lower sales penetration. Warehouse ancillary and other businesses gross margin when expressed as a percentage of net sales increased one basis point. Additionally, gross margin was negatively impacted by five basis points due to a LIFO charge of \$18 in the first thirty-six weeks of 2014 compared to a benefit of \$19 in 2013, and two basis points due to a non-recurring legal settlement received in the third quarter of 2013. The LIFO charge resulted from higher merchandise inventory costs, primarily in our food and sundries category. Continued growth of the Executive Membership 2% reward program also negatively impacted gross margin by one basis point. Changes in foreign currencies relative to the U.S. dollar negatively impacted gross margin by \$132 in the first thirty-six weeks of 2014.

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Item 2—Management’s Discussion and Analysis of Financial Condition and Results of Operations (Continued) (amounts in millions, except per share and share data, and warehouse count data)

Gross margin on a segment basis, when expressed as a percentage of the segment’s own sales, increased in our U.S. operations, primarily due to softlines and food and sundries. These increases were partially offset by the LIFO charge and non-recurring legal settlement discussed above. The gross margin percentage in our Canadian operations decreased, primarily due to decreases in hardlines as a result of its lower sales penetration as discussed above and softlines. The gross margin percentage in our Other International segment decreased, primarily due to food and sundries and hardlines.

Selling, General and Administrative Expenses

| | 12 Weeks Ended | | 36 Weeks Ended | |
|--|-----------------|-----------------|-----------------|-----------------|
| | May 11, 2014 | May 12, 2013 | May 11, 2014 | May 12, 2013 |
| SG&A expenses | \$2,487 | \$2,313 | \$7,519 | \$7,006 |
| SG&A expenses as a percentage of net sales | 9.86 | % 9.82 | % 9.96 | % 9.85 |

SG&A expenses as a percentage of net sales increased four basis points compared to the third quarter of 2013.

Excluding the effect of gasoline price deflation on net sales, SG&A expenses as a percentage of net sales increased one basis point. This increase was largely due to an increase in stock compensation expense of four basis points due to early vesting for long service and appreciation in the trading price of our stock. Central operating costs were higher by two basis points, primarily due to continued investment in modernizing our information systems, the cost of which is primarily being incurred by our U.S. operations. Warehouse operating costs were lower by five basis points, primarily resulting from improvements in payroll in our U.S. and Canadian operations as a result of leveraging increased sales, partially offset by increases in employee benefit costs. Changes in foreign currencies relative to the U.S. dollar decreased our SG&A expenses by \$30 in the third quarter of 2014.

SG&A expenses as a percentage of net sales increased eleven basis points compared to the first thirty-six weeks of 2013. Excluding the effect of gasoline price deflation on net sales, SG&A expenses increased seven basis points. This increase was largely due to an increase in stock compensation expense of four basis points due to early vesting for long service and appreciation in the trading price of our stock despite a 14% reduction in the average number of RSUs granted to each participant. Central operating costs were also higher by one basis point, primarily due to continued investment in modernizing our information systems, the cost of which is primarily being incurred by our U.S. operations. Warehouse operating costs increased two basis points compared to the first thirty-six weeks of 2013, due to higher employee benefit costs in our U.S. and Canadian operations. This was partially offset by improvements in payroll primarily in our Canadian operations as a result of leveraging increased sales. Changes in foreign currencies relative to the U.S. dollar decreased our SG&A expenses by \$109 in the first thirty-six weeks of 2014.

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Item 2—Management’s Discussion and Analysis of Financial Condition and Results of Operations (Continued) (amounts in millions, except per share and share data, and warehouse count data)

Preopening Expenses

| | 12 Weeks Ended | | 36 Weeks Ended | |
|---|-----------------|-----------------|-----------------|-----------------|
| | May 11, 2014 | May 12, 2013 | May 11, 2014 | May 12, 2013 |
| Preopening expenses | \$16 | \$10 | \$48 | \$34 |
| Warehouse openings, including relocations | | | | |
| United States | 2 | 1 | 13 | 10 |
| Canada | 0 | 0 | 2 | 3 |
| Other International | 2 | 4 | 5 | 6 |
| Total warehouse openings, including relocations | 4 | 5 | 20 | 19 |

Preopening expenses include costs for startup operations related to new warehouses, new international markets, and expansions at existing warehouses. Preopening expenses vary due to the number of warehouse openings, the timing of the opening relative to our quarter-end, whether the warehouse is owned or leased, and whether the opening is in an existing, new, or international market. Subsequent to the end of the third quarter 2014, we opened our first warehouse in Spain.

Interest Expense

| | 12 Weeks Ended | | 36 Weeks Ended | |
|------------------|-----------------|-----------------|-----------------|-----------------|
| | May 11, 2014 | May 12, 2013 | May 11, 2014 | May 12, 2013 |
| Interest expense | \$25 | \$25 | \$78 | \$63 |

Interest expense in the third quarter and first thirty-six weeks of 2014 primarily related to the \$1,100 of 5.5% Senior Notes issued in fiscal 2007 and the \$3,500 of Senior notes issued in December 2012. In the first thirty-six weeks of 2013, interest expense only included approximately 22 weeks of interest on the \$3,500 of Senior Notes, compared to 36 weeks in 2014.

Interest Income and Other, Net

| | 12 Weeks Ended | | 36 Weeks Ended | |
|--|-----------------|-----------------|-----------------|-----------------|
| | May 11, 2014 | May 12, 2013 | May 11, 2014 | May 12, 2013 |
| Interest income | \$11 | \$9 | \$35 | \$29 |
| Foreign-currency transaction gains (losses), net | (2 |) 0 | 14 | 21 |
| Other, net | 3 | 6 | 11 | 11 |
| Interest income and other, net | \$12 | \$15 | \$60 | \$61 |

The increase in interest income in the third quarter and first thirty-six weeks of 2014 was primarily driven by higher average cash, cash equivalents, and short-term investments balances and higher interest rates earned, primarily in our U.S. operations. The decrease in foreign-currency transaction gains, net in the first thirty-six weeks of 2014 was primarily attributable to the negative impact of mark-to-market adjustments for forward foreign exchange contracts, as the U.S. dollar weakened in certain international locations compared to the prior year. See Derivatives and Foreign Currency sections in Part I, Item I, Note 1 of this report.

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Item 2—Management’s Discussion and Analysis of Financial Condition and Results of Operations (Continued) (amounts in millions, except per share and share data, and warehouse count data)

Provision for Income Taxes

| | 12 Weeks Ended | | 36 Weeks Ended | |
|----------------------------|-----------------|-----------------|-----------------|-----------------|
| | May 11, 2014 | May 12, 2013 | May 11, 2014 | May 12, 2013 |
| Provision for income taxes | \$245 | \$248 | \$728 | \$658 |
| Effective tax rate | 33.9 | % 34.8 | % 34.5 | % 31.4 |

The actual effective tax rate for the third quarter was favorably impacted by a change in the estimated annual effective tax rate which decreased from 35.2% in the second quarter of 2014 to 34.8%. This change in estimate was predominately due to a change in expected annual pre-tax income between our domestic and international operations. For the third quarter and first thirty-six weeks of 2013 our estimated annual effective tax rate was 34.8%. Estimated annual effective tax rates exclude the impact of discrete tax items.

Additionally, our provision for income taxes for the first thirty-six weeks of 2013 was favorably impacted by discrete net tax benefits of \$72, primarily due to a \$62 tax benefit recorded in the second quarter of 2013 in connection with the special cash dividend paid to employees through our 401(k) Retirement Plan. Dividends paid on these shares were deductible for U.S. income tax purposes.

LIQUIDITY AND CAPITAL RESOURCES

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

| | 36 Weeks Ended | |
|---|-----------------|-----------------|
| | May 11, 2014 | May 12, 2013 |
| Net cash provided by operating activities | \$3,142 | \$2,874 |
| Net cash used in investing activities | (1,487 |) (1,116 |
| Net cash (used in) provided by financing activities | (542 |) 216 |

Our primary sources of liquidity are cash flows generated from warehouse operations, cash and cash equivalents, and short-term investment balances. Cash and cash equivalents and short-term investments were \$7,275 and \$6,124 at May 11, 2014, and September 1, 2013, respectively. Of these balances, approximately \$1,386 and \$1,254 represented debit and credit card receivables at the end of the third quarter of 2014 and of fiscal year 2013, respectively, primarily related to sales within the last week of our fiscal quarter or fiscal year.

Management believes that our cash position and operating cash flows will be sufficient to meet our capital requirements for the foreseeable future and that our U.S. current and projected asset position is sufficient to meet our U.S. liquidity requirements. As of May 11, 2014 we have not provided for U.S. deferred taxes on cumulative undistributed earnings of certain non-U.S. consolidated subsidiaries, as we deemed such earnings to be indefinitely reinvested. Such earnings could become taxable upon the sale or liquidation of these non-U.S. consolidated subsidiaries or upon dividend repatriation. At May 11, 2014, cash and cash equivalents and short-term investments totaling \$2,708 were held by these non-U.S. consolidated subsidiaries. Management is currently considering repatriating a portion of the undistributed earnings in Canada as current exchange rates as compared to historical exchange rates when these earnings were generated, which if done, would result in an immaterial U.S. tax liability.

Cash Flows from Operating Activities

Net cash provided by operating activities totaled \$3,142 in the first thirty-six weeks of 2014, compared to \$2,874 in the first thirty-six weeks of 2013. Our cash flow provided by operations is primarily derived from net sales and membership fees. Our cash flow used in operations generally consists of payments to our

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Item 2—Management’s Discussion and Analysis of Financial Condition and Results of Operations (Continued) (amounts in millions, except per share and share data, and warehouse count data)

merchandise vendors, warehouse operating costs including payroll and employee benefits, credit card processing fees, and utilities.

Cash Flows from Investing Activities

Net cash used in investing activities totaled \$1,487 in the first thirty-six weeks of 2014 compared to \$1,116 in the first thirty-six weeks of 2013. Our cash flow used in investing activities is primarily related to funding our warehouse expansion and remodeling activities. Net cash flows from investing activities also includes purchases and maturities of short-term investments.

Capital Expenditure Plans

We opened 20 new warehouses in the first thirty-six weeks of 2014. For the remainder of fiscal 2014 we plan to open up to 10 additional warehouses. Our primary requirement for capital is the financing of land, buildings, and equipment for new and remodeled warehouses. To a lesser extent, capital is required for initial warehouse operations, the modernization of our information systems, and working capital. While there can be no assurance that current expectations will be realized and plans are subject to change upon further review, it is our current intention to spend approximately \$2,200 during fiscal 2014 for real estate, construction, remodeling, equipment for warehouses and related operations, and the modernization of our information systems and related activities. These expenditures are expected to be financed with a combination of cash provided from operations and existing cash and cash equivalents and short-term investments. Through the first thirty-six weeks of fiscal 2014, we have spent approximately \$1,426.

Cash Flows from Financing Activities

Net cash used in financing activities totaled \$542 in the first thirty-six weeks of 2014 compared to \$216 provided in the first thirty-six weeks of 2013. The primary uses of cash in the first thirty-six weeks of 2014 were the quarterly dividend payments and the repurchases of common stock. The net cash provided by financing activities in the first thirty-six weeks of 2013 primarily resulted from the proceeds of the issuance of \$3,500 in aggregate principal amount of Senior Notes, which were used to fund a one-time special cash dividend of \$3,049 in December 2012. These cash flows did not recur.

Stock Repurchase Programs

In the third quarter and first thirty-six weeks of 2014, we repurchased 1,623,000 shares of common stock, at an average price of \$113.14, totaling \$184. There was no stock repurchase activity in the third quarter of 2013. In the first thirty-six weeks of 2013, we repurchased 357,000 shares, at an average price of \$96.41 per share, for a total expenditure of \$34. The remaining amount available for stock repurchases under our approved plan was \$2,871 at May 11, 2014. These amounts differ from the stock repurchase balances in the condensed consolidated statements of cash flows due to changes in unsettled stock repurchases at the end of a quarter. Purchases are made from time-to-time, as conditions warrant, in the open market or in block purchases, and pursuant to plans under SEC Rule 10b5-1. Repurchased shares are retired, in accordance with the Washington Business Corporation Act.

Dividends

Our current quarterly cash dividend rate is \$0.355 per share, or \$1.42 per share on an annualized basis. On April 29, 2014, our Board of Directors declared a quarterly cash dividend of \$0.355 per share payable to shareholders of record on May 16, 2014. The dividend was paid on May 30, 2014.

Bank Credit Facilities and Commercial Paper Programs

We maintain bank credit facilities for working capital and general corporate purposes. As of May 11, 2014, we had total borrowing capacity within these facilities of \$459, of which \$390 was maintained by our

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Item 2—Management’s Discussion and Analysis of Financial Condition and Results of Operations (Continued) (amounts in millions, except per share and share data, and warehouse count data)

international operations. Of this \$390, \$182 is guaranteed by the Company. There were \$79 of outstanding short-term borrowings under the bank credit facilities at the end of the third quarter of 2014 and \$36 outstanding as of the end of fiscal 2013.

The Company has letter of credit facilities, for commercial and standby letters of credit, totaling \$159. The outstanding commitments under these facilities at the end of the third quarter of 2014 were \$107, including \$97 in standby letters of credit with expiration dates within one year. The bank credit facilities have various expiration dates, all within one year, and we generally intend to renew these facilities prior to their expiration. The amount of borrowings available at any time under our bank credit facilities is reduced by the amount of standby and commercial letters of credit then outstanding.

Contractual Obligations

As of the date of this report, there were no material changes to our contractual obligations outside the ordinary course of business since the end of our last fiscal year.

Critical Accounting Estimates

The preparation of our consolidated financial statements in accordance with U.S. generally accepted accounting principles (U.S. GAAP) requires that we make estimates and judgments. We base our estimates and judgments on historical experience and on assumptions that we believe to be reasonable. Our critical accounting policies are discussed in Part II, 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 1, 2013. There have been no material changes to the critical accounting policies previously disclosed in that report.

Recent Accounting Pronouncements

See discussion of Recent Accounting Pronouncements in Note 1 to the condensed consolidated financial statements included in Part I, Item 1 of this Report.

Item 3—Quantitative and Qualitative Disclosures About Market Risk

Our exposure to financial market risk results from fluctuations in interest rates and foreign currency exchange rates. There have been no material changes to our market risks as disclosed in our Annual Report on Form 10-K, for the fiscal year ended September 1, 2013.

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.

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PART II—OTHER INFORMATION

Item 1—Legal Proceedings

See discussion of Legal Proceedings in Note 9 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 the 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 fiscal year ended September 1, 2013. 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 third quarter of fiscal 2014 (dollars in millions, 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⁾ |
|------------------------------------|----------------------------------|------------------------------|--|--|
| February 17, 2014 - March 16, 2014 | 60,000 | \$113.75 | 60,000 | \$3,048 |
| March 17, 2014 - April 13, 2014 | 906,000 | 112.46 | 906,000 | 2,946 |
| April 14, 2014 - May 11, 2014 | 657,000 | 114.01 | 657,000 | 2,871 |
| Total third quarter | 1,623,000 | \$113.14 | 1,623,000 | |

(1) Monthly information is presented by reference to our fiscal periods during the third quarter of fiscal 2014.

(2) Our stock repurchase program is conducted under a \$4,000 authorization of our Board of Directors approved in April 2011, which expires in April 2015.

Item 3—Defaults Upon Senior Securities

None.

Item 4—Mine Safety Disclosures

Not applicable.

Item 5—Other Information

None.

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Item 6—Exhibits

The following exhibits are filed as part of this Quarterly Report on Form 10-Q or are incorporated herein by reference.

| Exhibit Number | Exhibit Description | Filed Herewith | Incorporated by Reference | | |
|----------------|--|----------------|---------------------------|---------------|-------------|
| | | | Form | Period Ending | Filing Date |
| 3.1 | Articles of Incorporation of the registrant | | 8-K | | 8/30/1999 |
| 3.2 | Bylaws of the registrant | | 8-K | | 8/24/2010 |
| 31.1 | Rule 13(a) – 14(a) Certifications | x | | | |
| 32.1 | Section 1350 Certifications | x | | | |
| 101.INS | XBRL Instance Document | x | | | |
| 101.SCH | XBRL Taxonomy Extension Schema Document | x | | | |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document | x | | | |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document | x | | | |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document | x | | | |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document | x | | | |

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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)

June 4, 2014

Date

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

June 4, 2014

Date

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

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